APPENDIX A

IN THE UNITED STATES COURT OF APPEALS,
FEDERAL CIRCUIT

* * * * * * * * * * * * * *

CALIFORNIA FEDERAL BANK, FSB,

Plaintiff-Cross Appellant,

v.

UNITED STATES,

Defendant-Appellant.

Nos. 99-5108, -5119

DECIDED: April 3, 2001

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Theodore B. Olson, Gibson, Dunn & Crutcher, LLP, of Washington, DC, argued for plaintiff-cross appellant. With him on the brief were Theodore J. Boutrous, Jr., Mark A. Perry, and David B. Salmons. Of counsel were John C. Millian, and Paul Blankenstein.

Jeanne E. Davidson, Deputy Director, Commercial Litigation Branch, Civil Division, Department of Justice, of Washington, DC, argued for defendant-appellant. With her on the brief was David M. Cohen, Director, Commercial Litigation Branch. Of counsel on the brief were Lee M. Straus, Elizabeth W. Newsom, Kenneth M. Kulak, Tarek Sawi, and Teresa A. Kolb, Attorneys, Commercial Litigation Branch. Also of counsel on the brief were Scott R. McIntosh, Special Counsel; Thomas M. Bondy, and Susan

Pacholski, Trial Attorneys, Appellate Staff. Of counsel was Jonathan Lawlor, Trial Attorney, Commercial Litigation Branch.

Jerry Stouck, Spriggs & Hollingsworth, of Washington, DC, for amicus curiae Plaintiffs' Coordinating Committee. Of counsel on the brief were Charles J. Cooper, and Steven S. Rosenthal, Cooper, Carvin & Rosenthal, PLLC, of Washington, DC; and Melvin A. Garbow, Arnold & Porter, of Washington, DC.

John V. Thomas, Assistant General Counsel, Federal Deposit Insurance Corporation, of Washington, DC, amicus curiae for Federal Deposit Insurance Corporation. With him on the brief were Dorothy A. Doherty, Counsel; John M. Dorsey III, Senior Counsel; and Richard Gill, Counsel.

Before MAYER, Chief Judge, PLAGER, Senior Circuit Judge,* and LINN, Circuit Judge.

MAYER, Chief Judge.

The United States appeals the summary judgment of the United States Court of Federal Claims holding the government liable for breach of its contract with California Federal Bank (Cal Fed) pertaining to the regulatory treatment of a series of mergers of Cal Fed with other thrifts. *See California Fed. Bank v. United States*, 39 Fed. Cl. 753 (1997) (*Cal Fed I*). Cal Fed cross-appeals the Court of Federal Claims' denial of lost profits and restitutionary relief and its calculation of Cal Fed's costs due to the breach. *See California Fed. Bank v. United States*, 43 Fed. Cl. 445 (1999) (*Cal Fed II*). We affirm-in-part, vacate-in-part, and remand.

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* Judge Plager assumed senior status on November 30, 2000.

Background

The history and circumstances surrounding the thrift crisis of the early 1980s and the enactment of the Financial Institutions Reform, Recovery, and Enforcement Act (FIRREA), Pub. L. 101-73, 103 Stat. 183, in 1989 have been extensively discussed in the original *Winstar* cases and will not be revisited here. *See United States v. Winstar Corp.*, 518 U.S. 839, 843, 858 (1996) (*Winstar III*).

This action is one of more than 120 pending *Winstar*-related cases. To improve efficiency and preserve judicial resources, the Court of Federal Claims selected four exemplary cases, including this one, that it considered via hearings and summary judgment motions to decide the common issues pertaining to the liability of the government and to resolve dispositively any common issues for the remaining *Winstar*-related cases. The numerous plaintiffs were organized into a Plaintiffs Coordinating Committee (PCC) which identified 13 common issues it believed were raised in the government's summary judgment briefing. The court found 11 of these to be present in the four exemplary cases.

The transactions at issue here are threefold: 1) Cal Fed's 1982 acquisition of three Georgia thrifts and one Florida thrift (the Southeastern transaction); 2) Cal Fed's 1982 acquisition of Brentwood Savings and Loan Association (Brentwood), a California thrift; and 3) Cal Fed's 1983 acquisition of Family Savings and Loan Association (Family), a Nevada thrift.

In the Southeastern transaction, Cal Fed assumed $305.67 million in net liabilities through four supervisory mergers in February 1982. It entered into an assistance agreement with the government under which it received a forbearance letter permitting the excess liabilities to be recorded as supervisory goodwill and amortized over 35 to 40 years, and a $9 million capital credit from the Federal Savings and Loan Insurance Corporation (FSLIC) as an

additional inducement. Cal Fed later sold these southeastern thrifts. The government does not dispute the presence of a contract with Cal Fed regarding the Southeastern transaction because the assistance agreement contained a provision that explicitly incorporated the contemporaneous forbearance letters.

However, the government does contest the presence of a contract in the remaining two transactions, in which there was no capital credit inducement provided by the FSLIC and, accordingly, no assistance agreement explicitly incorporating the forbearance letters into a single document. By a September 2, 1982 letter, in its acquisition of Brentwood, Cal Fed specifically requested approval from the Federal Home Loan Bank Board (FHLBB) to amortize goodwill created by the acquisition over the estimated useful life of 35 years. The FHLBB approved the acquisition on September 30, 1982, and on October 1, 1982, issued a forbearance letter stipulating that the resulting association may amortize any goodwill created over 35 years. The FHLBB agreed not to enforce its net worth requirements for a period of five years to the extent that Cal Fed's failure to meet the requirements was attributable to the assets or liabilities acquired from Brentwood. Cal Fed assumed $314.63 million in net liabilities from Brentwood in October 1982.

The Family acquisition proceeded similarly, though the commitment regarding amortization of goodwill was contained in the Acquisition Agreement, Article 6.1(a), which stated that the resulting association of Cal Fed and Family may amortize any goodwill created under the purchase method of accounting using the straight line method over the useful life of 40 years. This amortization was structured in the agreement as a condition precedent to Cal Fed's obligations. The merger application sent to the FHLBB included the acquisition agreement and an additional request to approve the 40-year amortization. In two

subsequent forbearance letters dated November 26, 1982, and January 5, 1983, the FHLBB confirmed Cal Fed's entitlement to record the merger under the purchase method of accounting and amortize resulting goodwill over 40 years. Cal Fed assumed $17.74 million in net liabilities in its acquisition of Family in 1983. As in the Brentwood transaction, the FHLBB agreed not to enforce its net worth requirements for a period of five years to the extent that Cal Fed's failure to meet the requirements was attributable to the assets or liabilities acquired from Family. In all three transactions, Cal Fed was permitted to count goodwill as an asset for regulatory capital purposes for as long as it remained on their accounting records.

Cal Fed brought suit against the government in the Court of Federal Claims for breaching its merger agreements by enacting FIRREA, which forced the accelerated phase-out of goodwill over a five year period beginning in 1989. The court held on summary judgment that the government was liable for breach of its contract with Cal Fed and referred the case to trial on the issue of damages. Before trial, the court denied the claim for lost profits on summary judgment because of their highly speculative nature. After trial, the court awarded Cal Fed the sum of $22.967 million in damages as the cost of replacing the regulatory capital lost due to the accelerated phase out of goodwill under FIRREA. The court denied Cal Fed's request for restitution because it had not proven that its agreement to assume the net liabilities of the acquired thrifts was a cost in the circumstances of this case, and rejected wounded bank damages based on insufficient proof of causation. The United States appeals and Cal Fed cross-appeals.

Discussion

The Tucker Act grants the Court of Federal Claims jurisdiction over actions "founded either upon the Constitution, or any Act of Congress or any regulation of an

executive department, or upon any express or implied contract with the United States, or for liquidated or unliquidated damages in cases not sounding in tort." 28 U.S.C. § 1491(a)(1) (1994). We have jurisdiction under 28 U.S.C. § 1295(a)(3) (1994).

Summary judgment is appropriate if there is no genuine issue as to any material fact and the moving party is entitled to a judgment as a matter of law. We review a grant of summary judgment by the Court of Federal Claims *de novo* to determine whether the summary judgment standard has been correctly applied. *Winstar Corp. v. United States*, 64 F.3d 1531, 1539 (Fed. Cir. 1995) (en banc) (*Winstar II*) (citing *Anderson v. Liberty Lobby, Inc.*, 477 U.S. 242, 255 (1986)); *Southfork Sys., Inc. v. United States*, 141 F.3d 1124, 1131 (Fed. Cir. 1998).

Whether a contract exists is a mixed question of law and fact. *Cienega Gardens v. United States*, 194 F.3d 1231, 1239 (Fed. Cir. 1998) (citation omitted). We review the trial court's legal conclusions independently and its findings of fact for clear error. *Glendale Fed. Bank, FSB v. United States*, 239 F.3d 1374, 1379 (Fed. Cir. 2001). "[A]ny agreement can be a contract within the meaning of the Tucker Act, provided that it meets the requirements for a contract with the Government, specifically: mutual intent to contract including an offer and acceptance, consideration, and a Government representative who had actual authority to bind the Government." *Massie v. United States*, 166 F.3d 1184, 1188 (Fed. Cir. 1999) (quoting *Trauma Serv. Group v. United States*, 104 F.3d 1321, 1326 (Fed. Cir. 1997)). Contract interpretation is a question of law, which we review *de novo*. *Cienega Gardens*, 194 F.3d at 1239 (citing *Winstar II*, 64 F.3d at 1540).

I.

The government concedes that a contract existed in the Southeastern transaction, but argues that the absence of an

assistance agreement incorporating the forbearance letters precludes a finding that a contract existed in the Brentwood and Family transactions. *Winstar II*, however, did not rely exclusively on the assistance agreements to find a contract; it considered contemporaneous documents and surrounding circumstances that included forbearance letters like those present here. 64 F.3d at 1540. The assistance agreements were executed between acquiring thrifts and the government only in those situations where the government included a further inducement to the acquiring thrift to complete the transaction in the form of a capital credit. "Such credits arose when FSLIC itself contributed cash to further a supervisory merger and permitted the acquiring institution to count the FSLIC contribution as a permanent credit to regulatory capital." *Winstar III*, 518 U.S. at 853. The fact that Cal Fed did not enter into an assistance agreement by which it would receive direct cash assistance from the FSLIC in the Brentwood and Family transactions (as it did in the Southeastern transaction) is not dispositive of the issue of contract formation between the government and Cal Fed. Similarly, the difference in the form of consideration offered by the government in the Southeastern transaction, on the one hand, and the Brentwood and Family transactions, on the other, does not negate the bargained-for exchange in the latter two transactions. Here, as in *Winstar III*, the government bargained with Cal Fed to assume the net liabilities of the acquired thrifts in exchange for favorable regulatory consideration allowing goodwill to be counted as an asset for regulatory capital purposes and to be amortized over 35 to 40 years. We agree with the Court of Federal Claims that "[i]f the factual records of individual cases show intent to contract with the government for specified treatment of goodwill, and documents such as correspondence, memoranda and [FHLBB] resolutions confirm that intent, the absence of an [assistance agreement] or [supervisory action agreement] should be irrelevant to the finding that a contract

existed." *Cal. Fed. I*, 39 Fed. Cl. at 773. We therefore conclude that there were legally binding bargained-for exchanges in the Brentwood and Family transactions as well as in the Southeastern transaction.

We have no doubt that both the government and Cal Fed provided consideration for the agreements. Based on all of the contemporaneous documents in each of the three transactions, the FHLBB and the FSLIC were contractually bound to recognize the supervisory goodwill and the amortization periods reflected in the forbearance letters. In the Southeastern transaction, the government also was bound by the terms of the assistance agreement to provide a capital credit of $9 million in addition to the favorable regulatory treatment of supervisory goodwill. Cal Fed was reciprocally bound to assume the net liabilities of the acquired thrifts: $305.67 million in its acquisition of Southeastern, $314.63 million in its acquisition of Brentwood, and $17.74 million in its acquisition of Family. It is clear from the documents that this was the intent of the parties. As we held in *Winstar II*, "[i]f the parties did not intend to use supervisory goodwill for regulatory capital purposes there would simply be no reason for the extensive negotiations and the conditions regarding its use." *Winstar II*, 64 F.3d at 1542. "Once specific terms as to the amount of supervisory goodwill and its amortization periods under that regulatory policy were incorporated in a negotiated arm's length contract, both parties were bound to them." *Id.*

We have already answered the question of whether the FHLBB and the FSLIC have the authority to enter into contracts like these in the affirmative. *Id.* at 1548. Since its inception, the FSLIC has had the authority under 12 U.S.C. § 1725(c)(3) to make contracts. *Id.* Further, both the FSLIC and its supervisory agency, the FHLBB, have had "the authority both to extend assistance to acquirers of insolvent FSLIC-insured thrifts, 12 U.S.C. § 1729(f)(2)(A) (repealed),

and to set minimum capital limits on a case-by-case basis, 12 U.S.C. § 1730(t)(2) (repealed)." *Id.*

In *Winstar III*, the Supreme Court recognized that the issue of whether there was a contract between the thrifts and the government was not strictly before it, 518 U.S. at 860, but did not doubt this court's conclusion that the "overall 'documentation in the Winstar transaction establishes an express agreement allowing Winstar to proceed with the merger plan approved by the [FHLBB], including the recording of supervisory goodwill as a capital asset for regulatory capital purposes to be amortized over 35 years.'" 518 U.S. at 865-66 (quoting *Winstar II*, 64 F.3d at 1544). Just as in *Winstar III*, all of the necessary elements of contract formation are present here, and the parties are bound by the terms of that contract.

The government further argues that, even if there were contracts in the Brentwood and Family transactions, their term was limited to five years by the net worth forbearances. These allowed Cal Fed to be considered in compliance with its reserve and net worth requirements to the extent that any noncompliance is due to (a) operating or capital losses on acquired assets, (b) the amount of net liabilities of the acquired thrift, or (c) other items solely attributable to the acquisition. Because these five-year agreements expired prior to the passage of FIRREA, the government argues that FIRREA and its regulations did not breach any contracts with Cal Fed.

Notably, the government did not claim that the expiration of the net worth forbearances barred the inclusion of supervisory goodwill for regulatory capital purposes until the common issue proceedings that led to the instant summary judgment of liability in 1997. The Court of Federal Claims agreed with the PCC that two of the three *Winstar* test cases involved forbearance letters issued by the FHLBB that contained net worth forbearances similar, if not identical, to those now at issue. *Cal. Fed. I*, 39 Fed. Cl. at 760. In

those cases, the Supreme Court allowed amortization of goodwill over the entire period authorized by the forbearances and not merely for the five-year term of the net worth forbearances. *Winstar III*, 518 U.S. at 864-66. These contracts permitting special accounting treatment of supervisory goodwill were breached by FIRREA and its regulations. *Id.* at 866. We view the five-year expiration provision as relating only to the net worth forbearances that barred the FHLBB from enforcing its capital requirements for five years to the extent that any violation of those requirements was traceable to the subject acquisitions. The terms of the forbearance letters permitting the amortization over 35 to 40 years were separate and apart from the five-year enforcement-related terms. In any event, the five-year expiration provision of the net worth forbearances does not negate other obligations under the merger plan, including the specific time periods for amortization of goodwill. *Winstar II*, 64 F.3d at 1542.

As shown by the documentary evidence for the Brentwood and Family transactions, this long-term amortization of goodwill was a central consideration in Cal Fed's acquisitions. The documentary evidence for both the Brentwood and Family transactions demonstrates that purchase accounting and amortization of goodwill were essential terms of the negotiated transactions. There is no factual dispute concerning these documents, and they are precisely the type of evidence relied upon by the *Winstar* courts to establish the existence of contracts between acquiring thrifts and the government. Therefore, the government's breach of that contractual promise was substantial and material.

II.

We now turn to the matter of damages for the government's breach. Cal Fed sought expectancy damages in the form of lost profits from the forced shrinkage of its assets to reestablish capital compliance, and reimbursement

for the cost of replacing the capital previously provided by the supervisory goodwill with cash. Cal Fed additionally requested restitution of the benefit it had conferred on the government by assuming the net liabilities of the acquired thrifts. Finally, it sought reliance damages in the form of wounded bank damages allegedly incurred as a result of the government's withdrawal of the right to use supervisory goodwill as regulatory capital.

"One way the law makes the non breaching party whole is to give him the benefits he expected to receive had the breach not occurred." *Glendale*, 239 F.3d at 1380 (citing Restatement (Second) of Contracts § 344(a) (1981)). "The benefits that were expected from the contract, 'expectancy damages,' are often equated with lost profits, although they can include other damage elements as well." *Id.* (citing Restatement (Second) of Contracts § 347). Lost profits are "a recognized measure of damages where their loss is the proximate result of the breach and the fact that there would have been a profit is definitely established, and there is some basis on which a reasonable estimate of the amount of the profit can be made." *Neely v. United States*, 152 Ct. Cl. 137, 285 F.2d 438, 443 (1961).

According to *Wells Fargo v. United States*,

> "If the profits are such as would have accrued and grown out of the contract itself, as the direct and immediate results of its fulfillment, then they would form a just and proper item of damages, to be recovered against the delinquent party upon a breach of the agreement .... But if they are such as would have been realized by the party from other independent and collateral undertakings, although entered into in consequence and on the faith of the principal contract, then they are too uncertain and remote to be taken into

> consideration as a part of the damages occasioned by the breach of the contract in suit."

88 F.3d 1012, 1022-23 (Fed. Cir. 1996) (quoting *Ramsey v. United States*, 121 Ct. Cl. 426, 101 F. Supp. 353 (1951)). The subject of the contract between Cal Fed and the government was Cal Fed's assumption of the net liabilities of the acquired thrifts in exchange for the promised favorable regulatory treatment. The continued use of supervisory goodwill as regulatory capital for the entire 35-40 year amortization period initially promised was therefore a central focus of the contract and the subject of the government's breach. Profits on the use of the subject of the contract itself, here supervisory goodwill as regulatory capital, are recoverable as damages. *Id.*

Following pretrial hearings on expectancy damages generally, the trial court directed Cal Fed to submit "a concise list of lost profits claimed, along with reference to [written business plans, board resolutions and minutes, and internal memoranda] that will support such credits." *Cal. Fed. II*, 43 Fed. Cl. at 457. After reviewing the response to this order, along with a lengthy appendix that consisted mostly of business plans and related data, the Court of Federal Claims ruled that Cal Fed would not be able to establish lost profits as a matter of law. *Id.*

Cal Fed alleges that the government's breach eliminated about half of its regulatory capital, forced it to sell $4 billion of highly profitable assets, required it to forego making highly profitable loans, prevented it from leveraging the goodwill into earning assets, and increased its costs. Cal Fed presented documentary evidence to show that it sold significant assets in the wake of the breach. Its business plans and Office of Thrift Supervision documents allegedly showed its intent to invest in low risk assets that it claims have proven profitable. It provided specific documentation of 24,664 single-family adjustable rate mortgages worth

approximately $4 billion that it claims it was forced to sell to remain in capital compliance after the breach. Cal Fed then provided expert testimony, which traced the actual post-sale performance of these loans and arrived at lost profits of $317 million attributable to those sales. Additional documentary and deposition evidence was submitted to support Cal Fed's claim that in 1993 it was forced to sell a profitable business unit, California Thrift & Loan, to meet its capital requirements. It claimed the sale resulted in lost profits of $44 million. Cal Fed offered evidence of its past performance, its pre-breach business plans, data on the performance of other thrifts in the post-breach period, and historical evidence of assets that it allegedly had to sell to remain in capital compliance.

"If a reasonable probability of damage can be clearly established, uncertainty as to the amount will not preclude recovery." *Locke v. United States*, 151 Ct. Cl. 262, 283 F.2d 521, 524 (1960). The Supreme Court held in *Winstar III* that goodwill promises "allow[ed] the thrift to leverage more loans (and, it hoped, make more profits)." *Winstar III*, 518 U.S. at 851. The trial court correctly observed that the government "knew that breaching this agreement would cause [Cal Fed] to adjust its capital ratio. That is, it knew that [Cal Fed] would have to reduce its assets or increase its capital." *California Fed. Bank v. United States*, No. 92-138 C (Fed. Cl. Nov. 12, 1998) (Order). Both the existence of lost profits and their quantum are factual matters that should not be decided on summary judgment if material facts are in dispute. R. Ct. Fed. Cl. 56(c). Cal Fed submitted considerable evidence, including documents and expert testimony, that more than sufficed to create a genuine issue of material fact as to the existence and quantum of lost profits. The Court of Federal Claims erred by not permitting Cal Fed to present its evidence at a trial based on its legal conclusion that the proof would be too speculative. We

therefore vacate the summary judgment on lost profits and remand for trial on the issue.

Second, Cal Fed requested the cost of replacing the capital that formerly had been supplied by supervisory goodwill. Following trial on that issue, the Court of Federal Claims granted replacement costs for the transaction costs associated with various stock transactions Cal Fed used to replace the goodwill that was phased out by the breach. Cal Fed argues that this award was legally flawed because it failed to credit the true economic value of goodwill as a tool to leverage into earning assets and erroneously measured the replacement cost damages "on the day the stock is issued." This leverage argument is more appropriately applied to Cal Fed's claim for lost profits, which will be the subject of a new trial on remand. At trial, the Court of Federal Claims considered the conflicting testimony on the measurement of capital replacement costs by the parties' experts. The government's expert, Merton Miller, a Nobel Laureate in Economic Science, testified that the cost of replacing goodwill was floatation costs because the value of the cash proceeds of Cal Fed's newly-raised capital equaled the cost of future dividends. The court found Cal Fed's experts not credible. It discounted their testimony that the cost of replacing $390 million of goodwill was nearly a billion dollars, based in part on the cost of repurchasing all outstanding stock by Cal Fed to eliminate the cost of paying dividends. We see no clear error in the court's factual finding that the floatation costs provided an appropriate measure of Cal Fed's damages incurred in replacing the supervisory goodwill with tangible capital.

The idea behind restitution is to restore the non-breaching party to the position it would have been in had there never been a contract to breach. *Glendale*, 239 F.3d at 1380 (citing *Acme Process Equip. Co. v. United States*, 171 Ct. Cl. 324, 347 F.2d 509, 528 (1965)). Cal Fed argued

below that it was entitled to restitution equal to the benefit conferred upon the government by the Southeastern and Brentwood mergers. The Family transaction is not included in the restitution claim. The value of that benefit, it argued, should be calculated by taking each of the acquired thrift's obligations or debts at the time the contract was made, and subtracting from it the thrift's then assets, and then summing the results for Southeastern and Brentwood. Cal Fed claims that the resulting figure, a negative $620 million, represents the amount that the government benefited from the contract. It argues that while the benefit should be measured at the time of the respective mergers, it is appropriate to offset the resulting benefit by Cal Fed's earnings from the transactions, which it claims to be $211 million. Cal Fed therefore claims that it is entitled to $409 million as restitutionary damages. The government argues that Cal Fed conferred no such benefit because the FSLIC continued to possess a contingent liability to the depositors of Cal Fed and the acquired thrifts that was unchanged by the acquisitions, and that under no scenario at the date of the acquisitions would Cal Fed have ever paid the net liabilities. The government asserts that either interest rates would have fallen, erasing the net liabilities (as they did), or, if interest rates remained high, Cal Fed would have failed and the FSLIC would have been forced to make good on its contingent commitments to insure the affected depositors. The Court of Federal Claims denied restitutionary relief because Cal Fed had not been harmed by its assumption of the assets and liabilities of the failing thrifts it acquired.

We addressed a nearly identical claim for restitution in *Glendale*, 239 F.3d at 1381-82. There we rejected arguments akin to those now advanced by Cal Fed and the government as flawed.

> In the first place, it is clear that the Government's promise that was breached had

> substantial value . . . . Whether viewed as a grant of a special bookkeeping procedure for these cases, or as a promise to waive the regulatory requirement on capital reserves for a specified number of years, there can be no doubt that, for a banker interested in purchasing a failing thrift, the promise was of substantial value toward accomplishing that goal . . . .
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> At the same time, the action taken by the purchasing S & L in acquiring the failing thrift did not result in the Government, specifically the FSLIC, saving the dollar value of the net obligations of the thrift . . . . In a very real sense, what the Government received in exchange for its promise was time-time to deal with other failing S & Ls, time to see what the market would do before having to commit substantial resources to the problem. Though the value of time was more than zero, there is no proof of what in fact it was worth.

Id. We cited the contingent liability of the FSLIC and the possibility that Glendale and the acquired thrifts might have failed had interest rates not fallen. *Id.* at 1382. In light of those circumstances, we concluded that that case

> present[ed] an illustration of the problem in granting restitution based on an assumption that the non-breaching party is entitled to the supposed gains received by the breaching party, when those gains are both speculative and indeterminate. We do not see how the restitution award granted by the trial court, measured in terms of a liability that never came to pass, and based on a speculative

> assessment of what might have been, can be upheld; accordingly we vacate the trial court's damage award on this theory.

Id. There is no meaningful difference between the restitution claims in this case and *Glendale.* We do not fault the Court of Federal Claims' denial of restitution damages.'[1]

Conclusion

Accordingly, the judgment of the United States Court of Federal Claims is affirmed-in-part, vacated-in-part, and the case is remanded for further proceedings consistent with this opinion.

COSTS

Each party shall bear its own costs.

AFFIRMED-IN-PART, VACATED-IN-PART, AND REMANDED.

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[1] Before the trial court, Cal Fed requested wounded bank damages resulting from the government's withdrew of the right to use supervisory goodwill as capital, which Cal Fed claims placed it in a precarious financial position and was responsible for costs that it would not otherwise have incurred. These alleged costs included higher costs of deposits because of customer concern, higher assessment fees charged by regulators, and higher borrowing costs. The court denied wounded bank damages because cal fed failed to establish that the government's breach caused those financial difficulties. On this appeal, Cal Fed does not challenge that ruling.

APPENDIX B

IN THE UNITED STATES COURT
OF FEDERAL CLAIMS

* * * * * * * * * * * * * * *

CALIFORNIA FEDERAL BANK, *
A Federal Savings Bank,
*
Plaintiff,
*
v. No. 92-138 C
*
UNITED STATES of America, April 16, 1999
*
Defendant.

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Steven S. Rosenthal & Vince Colitriano, Cooper, Carvin & Rosenthal, PLLC, Ronald W. Stevens, & Joseph J. Brigati, Kirkpatrick & Lockhart, LLP, Richard D. Bernstein, Sidley & Austin, Washington, D.C., and Kenneth R. Heitz, Irell & Manella, LLP, Los Angeles, CA, for plaintiff.

Lee M. Strauss, Elizabeth W. Newsom, Renee Brooker, Delfa Castillo, Teresa A. Kolb, Kenneth M. Kulak, and Tarek Sawi, United States Department of Justice, Washington, D.C., for defendant.

OPINION

HODGES, Judge.

The Supreme Court has ruled that the United States breached its contracts with certain financial institutions when it enacted the financial Institutions Reform, Recovery, and Enforcement Act (FIRREA), *United States v. Winstar Corporation*, 518 U.S. 839 (1996). FIRREA eliminated the use of a special accounting treatment for banks' acquisitions of failing thrifts. Therefore, the law of this case is that the Government broke its promise to California Federal Bank (Cal Fed) that it could count "supervisory goodwill" as capital and amortize it over a period of 40 years. We are directed to determine the damages flowing from that breach of contract. *See California Federal Bank v. United States*, 39 Fed. Cl. 753 (1997).

Plaintiff argued that damages flowing from defendant's breach of contract totaled more than $1 billion. Cal Fed did not prove such damages at trial, however. It did not establish substantial losses that we could translate into damages properly awarded against the United States in this court. Cal Fed was a relatively healthy thrift before it entered into this contract, and it is healthy today.

Well-qualified experts for both sides testified during six weeks of trial. We questioned them closely concerning the nature and value of goodwill, which is the subject matter of this contract. We have considered all of that testimony and other evidence carefully. Plaintiff did not prove that it was damaged beyond the costs of raising capital to replace its goodwill.

BACKGROUND

The Federal Savings and Loan Insurance Corporation (FSLIC) lacked resources to rescue all of the failing thrifts during the savings and loan crisis of the 1980's. Therefore, the Federal Home Loan Bank Board encouraged healthier

thrifts to take over failing thrifts through supervisory mergers. As an incentive, acquiring entities were allowed to use "supervisory goodwill" toward their capital reserve requirements. Goodwill was the amount by which liabilities of the acquired failing thrifts exceeded their assets.

Cal Fed acquired four failing thrifts in Georgia and Florida through supervisory mergers in February 1982. Through a series of documents, a contract was created which authorized the merger of thrifts known as "Southeast" with Cal Fed.[1]

Cal Fed assumed approximately $305 million in net liabilities from the Southeast merger that was recorded on its books at goodwill. FSLIC gave Cal Fed $9 million for the transaction because the four Southeast thrifts were in danger of default. The goodwill was to be amortized over 35 to 40 years. Cal Fed sold most of the Southeast thrifts in Georgia in 1986, and sold the remainder of the Southeast division in 1994.

Cal Fed acquired Brentwood Savings and Loan through a supervisory merger in October 1982.[2] It assumed $315 million in net liabilities (goodwill) as a result of the transaction. The goodwill was to be amortized over 35 to 40 years.

Congress passed the Financial Institutions Reform, Recovery and Enforcement Act in 1989.[3] That law prohibited thrifts from continuing to count supervisory

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[1] The Southeast transaction consisted of four institutions: Peach State, United, Guaranty, and First Sylvania.

[2] Brentwood Savings and Loan was a single institution, located in California.

[3] *See Winstar*, 518 U.S. at 839, for a full discussion of FIRREA.

goodwill as part of their capital reserve. At the time of FIRREA, $390 million in goodwill remained on Cal Fed's books. After FIRREA, Cal Fed was forced to phase out its remaining goodwill in five steps between December 1989 and January 1995. Thus, all supervisory goodwill resulting from the Southeast and Brentwood transactions was removed from Cal Fed's books by 1995. The contractual schedule would have completed the phase-out of goodwill between 2017 and 2022.

SUMMARY OF OPINION

I. Assumption of Liabilities

Plaintiff was not harmed by its assumption of the assets and liabilities of the failing institutions that it acquired. The net liabilities assumed by plaintiff exceeded assets because of high mortgage interest rates and purchase accounting principles.[4] When interest rates fell, plaintiff no longer held liabilities that exceeded assets. Of the loans that Cal Fed sold prior to the interest rate decline, the proceed: were reinvested in fixed rate loans. This benefitted Cal Fed.

Plaintiff is not entitled to credit for the money that FSLIC might have saved from not having to liquidate the failing thrifts. It is not entitled to recover investment income that the Government may have earned on the funds FSLIC retained as a result of not having to liquidate the thrifts that Cal Fed took over. Cal Fed's acquisition of the failing thrifts was successful; they resulted in a going concern. Plaintiff

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[4] Purchase accounting permits "the acquiring entity to designate the excess of the purchase price over the fair value of all identifiable assets acquired intangible asset called 'good-will.'" *Winstar*, 518 U.S. at 848, 849. For a more detailed discussion of purchase accounting, *see Winstar*.

turned the failing thrifts around and made money from them, but no one knew at the time of contracting whether this would occur.

II. Wounded Bank Damages

Plaintiff's argument essentially is that defendant's withdrawal of Cal Fed's right to use goodwill as capital put the bank in a perilous financial condition that resulted in certain costs that plaintiff otherwise would not have incurred. These included higher costs of deposits because of customer concern, higher assessment fees charged by the regulators, and higher borrowing costs. Plaintiff did not establish a relationship between these costs and any actions by the federal government, however. If it had, plaintiff did not establish that defendant's breach caused those problems. If plaintiff was damaged at all from its contract with defendant, it has not made the showing necessary to support a substantial judgment against the United States. Evidence of $285 million in wounded bank costs was "too uncertain and remote to be taken into consideration as part of the damages occasioned by the breach of the contract in suit." *Myerle v. United States*, 33 Ct. Cl. 1, 26, 1800 WL 2024 (1897).

III. Lost Profits

We directed the parties not to argue lost profits at trial because it became clear that such damages would have been impermissibly vague and speculative. "The general rule in common law breach of contract cases is to award damages that will place the injured party in as good a position as he or she would have been in had the breaching party fully performed." *Estate of Berg v. United States.* 231 Ct. Cl. 466, 687 F.2d 377, 379 (1982) (citing *Northern Helex Co. v. United States.* 207 Ct. Cl. 862, 875, 524 F.2d 707, 713 (1975)). But what does "fully performed" mean in this case. Plaintiff performed its part--taking over the failing Southeast and Brentwood banks. Defendant's performance would have been allowing supervisory goodwill to count as capital for 33

more years. What consequences would such an allowance have had? How would plaintiff's fortunes have changed? Too many variables and unknowns prevent us from making a reasonable guess. "Remote and consequential damages are not recoverable in a common law breach of contract . . . especially . . . in suits against the United States for the recovery of common law damages ...." *Northern Helex,* 207 Ct. Cl. at 886, 524 F.2d 707.

IV. Replacement Costs

The subject matter of this contract is goodwill. The promise that defendant made to Cal Fed and others was that they could use goodwill as capital for a period of 35 to 40 years. The difficulty is that the goodwill has no value in this context. It is not as though the Government promised to buy 100 widgets then changed its mind. The Government in its regulatory mode told Cal Fed that it could take the amount by which the failing thrifts' liabilities exceeded their assets and call it "capital." Because goodwill has no monetary value, as 100 widgets might, the only importance that promise held for Cal Fed was that the goodwill made its capital ratios look better. Defendant did not guarantee that regulators would not close the bank anyway, because they take other indications of a bank's health into consideration. These include management, liquidity, loan appraisals, and underwriting procedures for example.

When Cal Fed no longer could use goodwill as capital, it replaced a useless accounting entry with real money. It was successful in replacing its goodwill and never was out of capital compliance. We cannot see how Cal Fed was damaged by replacing imaginary capital with real capital, other than having to pay certain operational costs that perhaps it would not have incurred otherwise. These are the costs that meet the tests of *Myerle* and other cases that are binding on this court.

DAMAGE REMEDIES

An early Supreme Court decision articulated various remedies available for breach of contract:

> When a party injured by the stoppage of a contract elects to rescind it, then, it is true, he cannot recover any damages for a breach of the contract, either for outlay or for loss of profits; he recovers the value of his services actually performed as upon a *quantum meruit* [restitution]. There is then no question of losses or profits. But when he elects to go for damages for the breach of the contract, the first and most obvious damage to be shown is, the amount which he has been induced to expend on the faith of the contract, including a fair allowance for his own time and services [reliance]. If he chooses to go further, and claims for the loss of anticipated profits [expectancy], he may do so, subject to the rules of law as to the character of the profits which may be thus claimed. *United States v. Behan*, 110 U.S. 338, 345 (1884).

I. Restitution

Restitution as a remedy has a flexible meaning and it may apply to a wide variety of fact situations. John D. Calamari & Joseph M. Perillo, *The Law of Contracts* § 15-2, at 648 (3d ed. 1987). The core principle of this remedy is that a person who has been unjustly enriched at the expense of another must make restitution to the injured party. *Restatement of Restitution* 1 (1937). This is not an operative rule, however, but a general principle. Calamari & Perillo, *supra,* § 15-2, at 648. Often restitution remains available where the defendant has not been enriched, but the plaintiff has suffered losses. *Id.*

Restitution is available whether the defendant breaches by nonperformance or by repudiation. *Restatement (Second) of Contracts* § 373 cmt. a (1981). Only cases of total breach, however, entitle plaintiff to restitution. *Id.* Traditionally, a suit for damages was deemed to be an attempt to enforce the contract while restitution could be obtained only after recission of the contract. This traditional view has left its imprint on the rules governing the availability of restitution and the measure of recovery. Calamari & Perillo, *supra,* § 15-3, at 649. However, it is now generally recognized that the right to damages or to restitution is the same because "both [are] remedial rights based on the contract." *Id.*

The aim of restitution is to place the plaintiff in the same economic position as it occupied before entering into the contract. Calamari & Perillo, *supra,* § 15-4, at 651. Plaintiff's recovery will amount to the reasonable value of "services rendered, goods delivered, or property conveyed less the reasonable value of any counter-performance received by him." *Id.*

The Court of Claims applied flexible principles of restitution in *Acme Process Equip., Co. v. United States*, 171 Ct. Cl. 324, 347 F.2d 509, 530 (1965). The court noted that when the defendant defaults, "restitution is permitted as an alternative remedy . . . in an effort to restore the innocent party to its pre-contract *status quo*, and not to prevent the unjust enrichment of the breaching party." *Id.* at 530.

II. Reliance

Reliance damages seek to place the plaintiff "in as good a position as he would have been in had the contract not been made." *Restatement (Second) of Contracts* § 344(b) (1981). Reliance damages include expenditures made "in preparing to perform, in performing, or in foregoing opportunities to make other contracts." *Restatement (Second) of Contracts* § 344 cmt. a (1981). This relief is awarded on "the assumption that the value of the contract would at least have covered

the outlay." Charles T. McCormick, Handbook on the Law of Damages § 142, at 586 (1935). Normally, the plaintiff seeks reliance damages when unable to prove expectancy with reasonable certainty because "failure to prove profits will not prevent the party from recovering his losses for actual outlay and expenditure." *Behan*, 110 U.S. at 345.

Reliance damages are subject to the ordinary limitations upon contract remedies: causation, certainty, and foreseeability. Dobbs, *supra*, §12.4, at 777-80. Defendant contends that plaintiff may not recover both on restitution and reliance. The Government cites two cases from this court in support of this proposition. *See Dolmatch Group, Ltd. v. United States*, 40 Fed. Cl. 431 (1998); *Pacific Architects & Eng'rs Inc. v. United States*, 203 Ct. Cl. 499, 491 F.2d 734 (1974). *Dolmatch* stands for the proposition that a "[p]laintiff cannot recover both expectancy and reliance damages on the same transaction." *Dolmatch*, 40 Fed. Cl. at 440. In *Pacific Architects*, the court found claiming restitution inconsistent with claiming anticipated profits. *Pacific Architects*, 203 Ct. Cl. at 516, 491 F.2d 734.

Plaintiff contends that it may recover restitution and non-overlapping items of reliance damages. "When a breach occurs after the execution of the contract, the injured party in a contract action is entitled to both restitution and reliance damages." *CBS, Inc. v. Merrick*, 716 F.2d 1292, 1296 (9th Cir. 1983). The Restatement would allow recovery of restitution and, for example, "damages to compensate him for costs of transportation of goods that he has incurred." *Restatement (Second) of Contracts* § 378 cmt. d (1981).

III. Expectancy

Expectancy damages give the plaintiff the "benefit of the bargain." E. Allan Farnsworth, *Contracts* § 12.1, at 840 (2d ed. 1990). The expectation interest is determined by measuring the actual value that the contract would have had to the

injured party had it been performed, not on the injured party's hopes at the time the contract was made. *Id.* at 841.

To recover lost profits for breach of contract, the plaintiff must establish that: (1) the loss is the proximate result of the breach; (2) the loss of profits caused by the breach was within the contemplation of the parties because the loss was foreseeable or because the defaulting party had knowledge of special circumstances at the time of contracting; and (3) a sufficient basis exists for estimating the amount of lost profits with reasonable certainty. *Chain Belt Co. v. United States*, 127 Ct. Cl. 38, 115 F. Supp. 701, 714 (1953).

Because often many factors combine to produce the result complained of, the causation prong requires the injured party to demonstrate that "the defendant's breach was 'a substantial factor' in causing the injury." Corbin, *supra*, § 999, at 25. The foreseeability prong may be satisfied in two ways. First, the breaching party may actually have foreseen the consequences of a breach. *Chain Belt*, 115 F. Supp. at 714. Second, the injured party may show that the consequences of the breach were foreseeable "in the ordinary course of events" even if unforeseen by the defendant. *Restatement (Second) of Contracts*, & 351(2)(a) (1981). "[T]he test is an objective one based on what he had reason to foresee." *Restatement (Second) of Contracts*, § 351 cmt. a. (1981). The damage amount is proven with reasonable certainty "if the evidence adduced enables the court to make a fair and reasonable approximation of damages." *Locke v. United States*, 151 Ct. Cl. 262, 283 F.2d 521, 524 (1960).

DISCUSSION

I. Assumption of Liabilities

Plaintiff assumed the assets and liabilities of Brentwood and Southeast in exchange for defendant's promise to count plaintiffs goodwill as capital for regulatory purposes and to amortize it over a forty-year period. Plaintiff contends that

its assumption of these liabilities was a cost incurred for which it should be reimbursed. According to plaintiff, the net liabilities assumed in the Southeast and Brentwood transactions were $305,672,000[5] and $314,630,000,[6] respectively. Plaintiff values the benefits that it received from the contracts at $209,000,000. This leaves net damages of $409,000,000.[7]

Plaintiff asserts that the $409 million cost was foreseeable at the time of contracting because the Government expected Cal Fed to assume Southeast's and Brentwood's liabilities, pay them over time, and operate the institutions in accordance with its business plan.[8] According to plaintiff, these liabilities were paid as they came due. Plaintiff contends that it did not recoup the initial cost associated with the acquisition of the failing thrifts.

The assumption of liabilities is a cost. For example, taking over the accounts payable of a business would be part of the consideration for its purchase. Assuming a seller's mortgage would be part of the consideration for buying a house. Liabilities in this case are in the form of deposits. They rep-

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[5] The figure for Southeast is net of a $9 million assistance payment received by California Federal from the Government.

[6] This represents the fair value of Brentwood's net liabilities plus $44 million in mutual capital certificates issued by California Federal.

[7] Plaintiff contended before trial that its net cost was $412 million, but reduced the amount during trial to account for additional post-acquisition earnings.

[8] Cal Fed submitted a business plan to the Federal Home Loan Bank Board prior to acquiring the failing institutions. This plan explained Cal Fed's strategy for turning the failing thrifts into healthy institutions.

resent liabilities to a bank because they are obligations that must be paid to a depositor on demand. Banks use deposits to leverage and grow; they are "the primary source of a thrift's franchise value," according to plaintiffs expert Professor Horvitz. We can foresee circumstances in which assumption of deposits would be a real cost that would fit one of the damages theories described above, but they were not a cost to this plaintiff. Cal Fed did not prove that its agreement to take over loans and deposits from Southeast and Brentwood was a cost in the circumstances of this case.

Plaintiff assumed net liabilities because high interest rates reduced the value of the assets it received. The effect of purchase accounting principles caused the value of these assets (loans) to be discounted from their face value. Interest rates fell after the parties entered the contract. Plaintiff was able to sell some loans and reinvest the proceeds, generally operating the bank profitably as a going concern.

Plaintiff argues that the fall in interest rates did not restore profitability to the failing thrifts for several reasons. *See* PX 1164, "Reasons Why the Decline in Interest Rates did not Solve the Problem." First, plaintiff claims that it sold many of the purchase accounting loans acquired in the Southeast/Brentwood transactions. Because it sold many of its loans prior to the fall in interest rates it did not get to take full advantage of these falling rates.

Cal Fed's decision to sell some of the loans it acquired was based on prudent business judgment. It devised a loan portfolio that it thought would be most profitable. Cal Fed sold "slightly less than 30 percent of the loans," according to Dr. Hamm. It held on to the other 70% until after the rates had fallen and when the market value of those loans were restored to par. Of the loans it sold, Cal Fed reinvested the proceeds. These were good management decisions.

Plaintiff would benefit from the fall in interest rates with respect to those loans sold if it reinvested the proceeds in

fixed rate loans. Dr. Hamm noted, "[t]o the extent Cal Fed continued to invest in fixed rate loans, it would restore its ability to benefit from a continued fall in interest rates ...." While Cal Fed complains that it sold 30% of the loans before interest rates fell, it did reinvest the proceeds from those sales. Cal Fed did not sell any loans during 1984-1986. By mid-1986 the loans were restored to their book value.

Proceeds of the loans that Cal Fed sold were reinvested, and plaintiff did not show that these reinvested proceeds lost money. Plaintiff did not isolate the performance of the reinvested proceeds in its analysis. Cal Fed continued to purchase fixed rate loans in 1982, 1983 and 1984.

When interest rates declined, the net liabilities disappeared. Cal Fed would not have survived had interest rates stayed at the high levels of the early 1980's; hardly anyone in the industry would have survived, according to Dr. Croft, a former regulator. Cal Fed paid the net liabilities as they became due, as plaintiff often argued, but it did so "initially by taking in deposits from other customers, but ultimately, it paid them out of the acquired assets. So there were no net liabilities. The acquired loans produced the income or revenue needed to honor the liabilities." These are crucial facts established through the testimony of Dr. Hamm. Cal Fed did not present convincing evidence to the contrary.

Second, plaintiff asserts that the decline in interest rates did not solve the problem because the institutions Cal Fed acquired had negative net interest income at the time of the acquisition. Plaintiff contends that Dr. Hamm's opinion that the negative spreads on the Brentwood and United loans originally acquired disappeared by mid-1983 is misleading because he based his analysis upon changes in the 6-month Treasury yield instead of Cost of Funds Index. After Cal Fed acquired the failing institutions in mid-1983, the acquired loans were generating funds to cover the acquired deposits. The correct interest rate to measure the fall in deposit costs is

the six-month Treasury yield, not the COFI according to defendant. This is because the six-month Treasury yield is a pure interest rate, whereas COFI is affected by other factors.

The fall in interest rates more than solved the problem. The rates "fell well beyond the point needed simply to achieve a break-even status," according to Dr. Hamm. Because of the fall in interest rates and the length of time they stayed below the initial negative operating spread, Cal Fed had time to generate income on the acquired assets to compensate for the period of time it was incurring losses and having to take on more interest-bearing liabilities to finance the losses.

The Cost of Funds Index does not reflect the true benefits derived from a fall in interest rates. According to Dr. Hamm, economically insolvent institutions searching for a way to expand put on nondeposit liabilities that were expensive in a high interest rate environment. These liabilities tended to "keep up" the cost of funds index, causing it to be higher than it should. Moreover, if California institutions changed the maturity structure of their liabilities, that would have an impact on the cost of funds index. This would reduce its value as a measure of the benefits plaintiff received from the fall in interest rates.

The initial net negative spread was eliminated by late 1983, and during the next three years interest rates continued to fall. This provided Cal Fed with the ability to make more profits to offset any initial losses that it may have incurred. The six-month Treasury yield was an appropriate measure to use for interest rates, and plaintiff was compensated for the initial negative net interest income.

Third, plaintiff argues that it diversified into new lines of business that were not as sensitive to interest rate fluctuations, so it did not receive any benefit from the decline in interest rates. Cal Fed did diversify its holdings, but this does not entitle it to damages. Diversification is irrelevant to

whether the fall in interest rates solved the problem. If Cal Fed had losses as a result of selling fixed-rate loans, the decision to sell was based on management decisions. The losses are not a result of the breach and are not costs of acquiring the institutions. Moreover, Cal Fed does not provide evidence of profits or losses on the reinvested proceeds. Such damages are based on pure speculation.

A. Insolvent on a Mark-to-Market Basis

Defendant contends that plaintiff's assumption of Southeast and Brentwood liabilities was not a cost because Cal Fed was insolvent on a mark-to-market basis. Cal Fed had no tangible capital with which to pay the acquired liabilities so they could not have been a cost incurred by plaintiff, according to defendant. Plaintiff was insolvent by $1.6 billion in February 1982 and $1.1 billion in October 1982. Defendant asserts that Cal Fed's insolvency meant that it took no risk when it acquired these institutions; it made no economic investment.

Plaintiff argues that its solvency when it entered into the contracts with the Government in 1982 is irrelevant. The Government reasonably concluded that Cal Fed would pay the acquired institutions' liabilities as they came due, according to plaintiff. It is plaintiff's argument that a mark-to-market analysis does not measure the ability of a thrift to pay liabilities over time. Rather, a "going concern" analysis better measures a thrift's ability to payoff liabilities. Plaintiff's experts testified that Cal Fed had "going concern" value in 1982.[9]

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[9] Going Concern value is "the opportunity to earn future profits," according to Professor Horvitz.

Plaintiff's expert Dr. Horvitz was questioned extensively about Cal Fed's ability to pay liabilities of the acquired institutions if Cal Fed was actually insolvent on a mark-to-market basis. Dr. Horvitz eventually stated that he had not made that calculation. He conceded that "the majority of institutions were at least to some extent mark-to-market value insolvent during the period."

While Cal Fed may have been insolvent on a mark-to-market basis, we agree that it is irrelevant for determining damages in this case. Plaintiff was not required to pay all of the liabilities of the acquiring institutions at one time. They were paid as they came due. Plaintiff may not have been able to payoff all of the deposits of the acquired institutions had every depositor requested his or her money back on the same day, but it could and did pay the deposits back over time.

B. Operating Costs

Plaintiff contends that it is entitled to the costs of operating the Southeast and Brentwood institutions because such costs were reasonable and foreseeable. The Government approved Cal Fed's business plan and encouraged its strategy to reduce interest rate risk, plaintiff argues, so defendant is liable for those costs.

We are not persuaded that the contracts required California Federal to operate these banks in accordance with any Government plan. The Supreme Court ruled that the United States was contractually obligated to permit financial institutions to apply special accounting treatment with regard to the acquisitions of failing thrifts. *United States v. Winstar Corp.*, 518 U.S. 839, 848 (1996). The contract in this case consists of numerous documents. Nothing in the contract suggests that the Government could in any way control plaintiffs operation of the institutions. The failing institutions were to be "merged" into California Federal Savings and Loan. Neither the Federal Home Loan Bank Board nor the

regulators could dictate Cal Fed's business decisions with respect to those institutions.

A witness who was president when the contracts were entered into testified that the regulators never told him how to operate the institutions or what assets to buy, sell, or retain. They did not tell Cal Fed itself what liabilities to buy, sell, or retain. Dr. Croft, the former director of the Office of Examinations and Supervision at the Federal Home Loan Bank Board, testified that thrifts were encouraged to be "proactive" but they were not guaranteed a profit. He testified that the thrifts were not guaranteed they would grow or that if they engaged in different lines of businesses and lost money that the Government would underwrite those losses.

It was foreseeable at the time of contracting that Cal Fed would pay the acquired institutions' liabilities as they came due, but it was not foreseeable that the Government would be responsible for losses arising from operating the institutions in accordance with Cal Fed's business plan. When the Government approved Cal Fed's business plan it did not insure Cal Fed against all losses arising from that plan. Plaintiff merely informed the regulators that it had a plan to turn these failing thrifts into profitable ones.

While Cal Fed did have to pay the operating costs of the acquired institutions, the interest rates fell far enough to fund those costs. Dr. Hamm testified that plaintiff's damages model takes into account virtually every business decision that Cal Fed made between January 1983 to the present day. He stated, for example, "every time Cal Fed writes a check that affects either Brentwood's costs or Southeast's costs . . . [or] decides to run an advertisement in Southern California . . . that's going to cause the profits attributed to Brentwood to go down." As Dr. Hamm points out, under plaintiffs model if Cal Fed decides to double the employees in the mergers and acquisitions department for the Southeast institutions, it would cause Southeast's costs to go up. These

wholly unrelated business decisions cannot be linked to plaintiff's assumption of the acquired institutions' liabilities.

Plaintiff's expert Mr. Taylor calculated Southeast's and Brentwood's net costs. He took operating expenses that could be booked to the Southeast division and then added an additional $234 million of expenses that were booked to the California division. Defendant asked whether Cal Fed would have saved $234 million in expenses if the Southeast acquisition had not happened. He responded, "I guess I do know that they would have saved money. I don't know what amount it would have been." We cannot base damages on pure speculation.

Mr. Taylor determined Brentwood's net costs for the 1983-1998 period by allocating to Brentwood 10.4% of the accretion income. This was based on his determination that Brentwood held 10.4% of Cal Fed's California deposit base. Plaintiff believes that deposit share was the best basis for apportioning net income between Brentwood and Cal Fed.

Defendant contends that Cal Fed's failure to credit Brentwood with accretion from Brentwood loans in measuring Brentwood's profitability is improper. The accretion relates solely to the Brentwood loans and not to other Cal Fed loans. Correcting this error results in a net benefit to Cal Fed rather than a loss.

The purpose of apportionment is to measure the separate contributions of Brentwood and Cal Fed as a means of crediting the Government with benefits Cal Fed received from the contract. Dr. Hamm testified that "deposits are not a reliable predictor of branch profitability." While deposits can be a factor in determining the profitability of a thrift, they are not the determining factor. Dr. Hamm stated that many thrifts have mediumly or below average deposit bases yet "are among the most profitable in the system because they have a low-cost structure . . . [or] produce a lot of revenue in the

form of cross-selling to customers on assets or products offered by the company."

C. Investment Income

Plaintiff argues that the Southeast and Brentwood mergers provided cost savings to the FSLIC and thus substantially reduced the risk to the insurance funds. In doing this, the Government saved millions of dollars that they would have had to payout to liquidate these failing thrifts. According to plaintiff, the benefit that the Government received was the investment income that the Government was able to earn on the funds the FSLIC retained as a consequence of Cal Fed's performance.

Defendant contends that the Brentwood and Southeast institutions would not have been liquidated if Cal Fed had not acquired them. The Federal Home Loan Bank Board policy was to "ride out" the period of high interest rates and help savings and loans appear healthy, according to defendant. Options available to the FHLBB were approving acquisitions, reducing capital requirements, offering direct assistance, and issuing income capital and net worth certificates. Various accounting measures also allowed some thrifts to remain open. Defendant argues that it would not have been necessary to liquidate.

The Government had not made a decision to liquidate Brentwood or Southeast at the time of contracting with Cal Fed. It had several alternatives to liquidation available. The failing thrifts became profitable, as did Cal Fed. But no one knew this would be true at the time the contracts were executed. Plaintiff could have failed and FSLIC would have been responsible for paying off deposits for Cal Fed, Brent-

wood and the Southeast institutions. The disgorgement theory offered by plaintiff was not convincing.[10]

If plaintiff ultimately profited from assuming the liabilities of the failing institutions, then any damages awarded to plaintiff based on its assumption of those liabilities would be a windfall. For that reason, it would be improper for this court to look solely to the day of contracting to determine damages. Here, the fall in interest rates more than covered any costs plaintiff incurred in assuming the liabilities of the failing thrifts.

II. Wounded Bank Damages

Plaintiff seeks about $285 million in "wounded bank costs" arising from the breach. To justify award of such costs, plaintiff must show that they resulted "inevitably and naturally, not possibly nor even probably the breach." *Myerle,* 33 Ct. Cl. at 27. Instead, plaintiff merely added up its "Net Increase Cost of Deposits" 1991-1998, its "Net Increase Regulatory Costs" 1993-1998, and its "Net Increased Cost of Borrowing" 1992-1998, and charged the entire amount to the Government. We have nothing but conjecture to support the notion that all of these increased costs are attributable to the breach. Indeed, it would be a remarkable coincidence if all increased costs claimed by plaintiff in these categories were caused by the breach. During parts of these periods Cal Fed held over a billion dollars in nonperforming assets. Its prime lending area was suffering a severe recession. Its loan losses were substantial. In this case, $285 million in wounded bank costs is "too uncertain and remote to be taken into consideration as a part of the damages occa-

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[10] Defendant argues that these damages amount to impermissible pre-judgment interest, but it is not necessary to address that point.

sioned by the breach of the contract in suit." *Myerle,* 33 Ct. Cl. at 26.

Plaintiff offered the testimony of Mr. Petitti who was Executive Vice President in charge of marketing operations for the bank 1992-1995. On direct, he discussed customer concerns about the bank's health as a result of the breach, and how the bank would deal with these concerns. He conducted special training sessions on how to respond to customers, for example. On cross, however, were the following exchanges:

Q: And do you contend that there were deposit outflows as a result of the problem institution designation?[11]

A: Yes.

Q: And what was the volume of the deposit outflows? A: I can't give you a number.

Q: How significant was it?

A: I think it was significant, but I can't tell you that it caused an outflow on a particular day. I think it was a cumulative effect and it just added to the concern of the customer base.

Q: And what evidence do you have of that?

A: The reaction that people had and my memory of people coming in the branches with the articles, people closing accounts.

Q: Isn't it a fact that Cal Fed thought FIRREA was good news because FIRREA would cause liquidation of institutions that offer above market rates on deposits.

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[11] We could not establish that the "problem institution designation" was caused by the breach.

A: That's what this [Cal Fed Outlook Memorandum] says. Q: So that's what Cal Fed was telling its people at the time, correct?

A: Yes.

Q: And Cal Fed was also predicting that FIRREA would actually restore the public confidence in the industry; isn't that correct?

A: Yes.

Plaintiff offered this additional testimony on redirect:

Q: Mr. Petitti, during the period 1990 through 1996, did you have personal conversations with Cal Fed depositors about their concerns about the Bank's viability?

A: Yes I did.

Q: In what context did you have those?

A: Well, I would, in the course of my responsibilities, I would visit branches, I would occasionally talk to customers. When I did that, I would also get calls from customers occasionally, and of course, I would have many conversations with the branch people themselves.

Such testimony does not provide a basis for awarding damages. Expert testimony on the point was not convincing. Even if the phase-out of goodwill as capital had *some* impact on the bank's costs of doing business, we would have to know that higher costs of deposits and other damages that plaintiff terms "wounded bank" were attributable to the breach. We think it far more likely that other factors caused the bank's problems, including its financial condition unrelated to the breach.

Much of plaintiffs case for higher costs of funds as evidence of wounded bank damages is based on changes before

and after the breach in its comparative standing vis-a-vis other banks in the 11th district. However, its arguments in this regard were not convincing. The charts showing cost of funds over a period of years did not consistently show that the breach had an effect, or that any such effect could not have had an independent cause. Some of Cal Fed's highest costs of funds were during a period when it was well capitalized. One expert speculated that the bank would have been healthier after the breach had it not acquired the thrifts, Southeast and Brentwood, in 1982. While it is possible that this is so, we cannot make such a finding of fact. Any number of factors could affect a bank's capital ratio during a given period of time.

Plaintiff's arguments in several respects during this trial were harmed by its lack of supporting documentation in several respects. This was particularly true of the wounded bank issue. For example, one of plaintiffs experts, Dr. Smith, stated on cross that he had worked on this case for three years, but never had he seen a document in which the bank expresses concern about the effects of the breach on costs of funds or costs of deposits.

We were receptive to the notion that higher assessment fees, at least, could be attributed to any problems that the bank experienced after the breach with regard to its capital ratios and other indications of health. As in the case of most insurance, higher risk calls for higher premiums. Banks with higher MACRO[12] ratings pay higher assessments. Capital is only one element that goes into determining a bank's rating.

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12 The MACRO rating is based on five factors that indicate the health of a financial institution. These are Management, Asset Quality, Capital, Risk Management/Liquidity, and Operations/Earnings.

A government regulator testified that asset quality was the element that weighed most heavily in determining Cal Fed's MACRO rating 1991-1994. Cal Fed's rating improved in 1994 as goodwill was being phased out. The government regulator, Mr. Buting, showed that problem assets were the main reason for Cal Fed's bad ratings earlier. In short, we cannot establish a connection between defendant's breach of the contract and plaintiffs costs of deposits, costs of borrowing, or regulatory assessments sufficient to find causation.

III. Lost Profits

We held a number of pretrial hearings to discuss various aspects of how the trial would be conducted, and to deal with motions *in limine* and other matters. An important topic during these hearings was expectancy damages, and how they would be proved at trial. The parties briefed *Wells Fargo* and its meaning for our purposes, and we heard oral arguments on *Wells Fargo* and on expectancy damages generally. *Wells Fargo Bank, NA. v. United States,* 88 F.3d 1012 (Fed. Cir. 1996), *cert. denied,* 520 U.S. 1116 (1997). In an October 9 Order, we stated that Cal Fed "should be prepared to show that the Bank was profitable in the years prior to the breach, and that it would have continued to make profits with the money that it lost .... We do not expect to hear testimony from experts concerning how the money might have been invested to achieve maximum profits." We directed plaintiff to submit "a concise list of lost profits claimed, along with reference to [written business plans, board resolutions and minutes, and internal memoranda] that will support such profits."

After reviewing plaintiffs response to this Order, along with a lengthy Appendix that consisted mostly of business plans and related data, we ruled that Cal Fed would not be able to establish lost profits as a matter of law. A November 12 Order stated in part, "Defendant knew that breaching this agreement would cause plaintiff to adjust its capital ratio.

That is, it knew that plaintiff would have to reduce its assets or increase its capital. But it could not foresee what effect this adjustment would have on plaintiff's profits. Banking was a volatile and dynamic business at the time of breach. These factors make expectancy damages particularly speculative. In these circumstances, plaintiff cannot prove clearly and with certainty that it would have made profitable loans and other profitable investments with the 'lost' capital. The Government promised to permit the use of goodwill as capital, but it did not guarantee plaintiff that its use of the additional leverage would be profitable."

The cases that everyone cites on the issue of lost profits, other than *Wells Fargo,* are *Neely I, Neely II,* and *Chain Belt, Neely v. United States,* 152 Ct. Cl. 137, 285 F.2d 438 (1961) (*Neely I*); *Neely v. United States,* 167 Ct. Cl. 407, 1964 WL 8619 (1964) *(Neely II); Chain Belt Co. v. United States,* 127 Ct. Cl. 38, 115 F. Supp. 701 (1953). Both parties here cited them as support for their positions. *Neely I, Neely II* and *Chain Belt* are among the very few cases on lost profits that were decided against the United States. It is instructive, therefore, to see how those cases differ from others in which plaintiffs were not successful, and from this one.

In *Neely I,* the Government breached its agreement to allow plaintiff to strip-mine certain lands for coal. Anticipated profits "is a recognized measure of damages, where their loss is the proximate result of the breach *and the fact that there would have been a profit is definitely established,* and there is some basis on which a reasonable estimate of the amount of the profit can be made." *Neely I,* 285 F.2d at 443, (emphasis added). The court discussed how difficult it is to establish lost profits in that "profits are uncertain; they depend on so many contingencies, especially in a new enterprise, that it is, in most cases, impossible to say that the breach was the proximate cause of the loss of them, or that a profit would have been realized, in any event: nor is there any basis to de-

termine what they might have amounted to. This is especially true where the breach occurred before operations had begun." *Id.*

The court pointed out however that here "some four or five years after the breach, the leased lands were actually strip-mined and 132,000 tons of coal were extracted .... [T]he profit realized from these operations, if, indeed, there were profits, would furnish some basis for a fairly reliable estimate of what plaintiffs profits would have been." *Id.* The court remanded the case to obtain a reasonable basis for making such findings. On remand, the trial court discussed the "problem of attempting to determine what would have happened if the plaintiff had been permitted to strip-mine ... in accordance with his desire." *Neely II,* 167 Ct. Cl. at 407. However, defendant in that case conceded that the plaintiff, "if he had been permitted to strip-mine the 2162.71 acres of public land ... could reasonably have made profits totaling $154,446.97." *Id.*

Note the important differences between this case and ours. The numbers are exact. In *Neely I,* we find that 132,000 tons of coal actually were extracted from that tract (exactly 2162.71 acres). The trial commissioner was able to deduct 28,000 tons of coal that lay beneath the roadways, which plaintiff would not have been to obtain permission to relocate. Such precise information permits a determination of damages through simple mathematical calculations. The efforts that the Court of Claims and the Trial Commissioner made to determine a precise figure establish how difficult it is to prove lost profits against the United States. Even though they are cited by the plaintiffs in this case, *Neely I* and *Neely II* do not support their highly speculative theory of lost profits.

In *Chain Belt,* the Government breached its agreement to remove machinery from plaintiff's premises on the date agreed. Plaintiff sued on several grounds, including lost

profits. That is, "plaintiff was prevented from making profitable use of the floor space so occupied for the period of such delay .... Even in the case of an established business it is only possible to estimate the amount of profits that would have been earned if the contracting question had not been breached, but the courts will make that estimate if a reasonable basis therefor is provided." *Chain Belt*, 115 F. Supp. at 714-716. "In our opinion it is reasonable to conclude from the evidence of record ... that the additional capacity of plaintiffs new plant would have resulted in increased earnings approximately equivalent to the earnings realized by plaintiff from its other manufacturing facilities." *Id.* at 718.

Once again, the detailed damages information available to the court in that case is striking by comparison to ours. Plaintiff established its sales for the ten-year period previous to the breach, and proved a profit ratio on sales "of approximately 17.8%." *Id.* at 719. The court knew exactly what the total productive floor area of plaintiff's plants was (597,645 square feet) and was able to establish plaintiff's net profit per square foot ($0.0118). "The total productive floor space in a new building, denied to plaintiff for the 67 days, consisted of 208,040 square feet." *Id.* at 719-720. Therefore the court established that "plaintiff lost $91,761.78 in profits during the 67 days it was delayed by defendant from having the use of the 116,066 square feet of plant, figured on the basis of $0.0118 per square foot as profit for each calendar day of delay." *Id.* at 720.

In *Penn Foundry,* the court allowed anticipated profits because of defendant's breach of contract. The Supreme Court reversed because plaintiff did not have the capital, know-how, and necessary trained employees to complete the contract. *Penn Foundry & Mfg. Co. v. United States.* 110 Ct. Cl. 374, 75 F. Supp. 319, *rev'd,* 337 U.S. 198. Therefore, the Government's breach was not the direct cause of plaintiff's failure to earn profits. While we do not question plain-

tiff's management know-how or the training of its employees, this case does highlight the difficulty of proving profits against the United States. Breach does not automatically equal damages; other factors are taken into consideration.

IV. Replacing Goodwill

A. Shrinking the Bank

When goodwill was phased out as capital, plaintiff had two options for meeting its capital requirements. It could raise new capital to support the assets it had, or it could reduce its assets to a level that current capital would support. Cal Fed asserts that the loss of goodwill as capital forced it to shrink the bank to meet its capital ratios.

It is clear from the testimony presented at trial that Cal Fed sold off assets and shrank in size. The cause of this shrinkage is unclear. Cal Fed suffered significant losses due to the California real estate recession and it saw an increase in nonperforming assets. It is possible shrinking the bank was a result of these losses. Plaintiff did not prove that shrinking the bank was a result of the breach, or even that it was harmful. It may have been the result of prudent management decisions.

B. Goodwill is Not Capital

Plaintiff argues that its loss of goodwill as capital was a cost for which it should be reimbursed. However, goodwill is not a cost that should be reimbursed dollar for dollar. Cal Fed quantified goodwill on its books and used that number to meet its capital requirements. While goodwill was used as capital for those purposes, it is not equivalent to capital and does not have a dollar for dollar value. It could be used to meet capital requirements only because the Government said so. Supervisory goodwill was merely an accounting gimmick, used by Cal Fed to meet its federal capital requirement and to keep the regulators at bay.

Goodwill kept the regulators at bay only with regard to Cal Fed's capital ratios, however. The regulators monitor other factors related to a bank's health, and they could have faulted Cal Fed in other areas. Mr. Buting, a government regulator for the Office of Thrift Supervision, testified that OTS performs examination reviews on thrifts that are in capital compliance to determine if they are "operating prudently and safely and soundly." Even though a thrift may meet capital requirements, it can be "taking all kinds of risks, making loans without appraisals, for instance, not following underwriting procedures, not having internal controls. They could have all types of activities that could jeopardize that status, so we would want to be in there every year to look and make sure that that's not the case." The only value that supervisory goodwill had for Cal Fed was its being counted toward core and risk-based capital requirements, according to Mr. Buting.

Goodwill was recognized as an accounting gimmick by the Supreme Court in *Winstar*. The Supreme Court explained that one of FIRREA's purposes was to "eliminat(e] the very accounting 'gimmicks' that acquiring thrifts had been promised." *Winstar* 518 U.S. at 841. The concept of goodwill was explained by Dean Fischel of the University of Chicago Law School and director of the law and economics program at the University of Chicago. He testified:

> Supervisory goodwill is an accounting concept which banking regulators in the 1980s allowed savings and loans to use as an alternative to real capital for purposes of meeting capital requirements. It's frequently referred to as one of many different forms of accounting gimmicks which allowed insolvent or close to insolvent institutions to appear solvent for regulatory purposes, even though as an economic matter, they had insufficient

> capital to be able to meet the then-existing capital requirements.
>
> * * * *
>
> It's not a real asset. A real asset is an asset that you earn an economic return on, like either a stock or a bond or a piece of land, or anything real where you have an expectation of appreciation, either in the form of interest, dividend payments, capital gains; any type of economic return along those lines. But because supervisory goodwill is an accounting fiction, it's not real. You earn no economic return on something that's not real.

So goodwill is not equivalent to capital; it is a unique bookkeeping entry with no clear equivalent. It is an accounting plug.

When Cal Fed's goodwill was taken away by FIRREA, plaintiff replaced it with real capital. Cal Fed is not entitled to the capital equivalent of goodwill because that amount is far greater than any damages that plaintiff proved at trial. The breach forced Cal Fed to replace its goodwill with capital, and the damages suffered by Cal Fed are the costs of that replacement.

V. Replacement Costs

Plaintiff was required to phase out goodwill from its books much faster than its contract provided because of defendant's breach. This forced Cal Fed to replace the goodwill with "real money" to meet capital requirements. Cal Fed was successful in replacing its goodwill, and in fact never fell out of capital compliance. The costs of raising replacement capital are the damages that we award by this opinion, and the subject of this section.

The Government argues that plaintiff is entitled only to the transaction costs involved in replacing the goodwill that was phased out by its breach. Because Cal Fed replaced goodwill by flowing money down from its holding company, such costs were very limited, according to defendant, about $1.5 million. Plaintiff contends that the holding company flow-down did not replace the lost goodwill. Cal Fed raised capital through various stock transactions and it is entitled to the costs of those transactions. Plaintiff includes in these costs the cost of repurchasing the issued stock to eliminate the need to pay dividends.

We agree with the defendant in part and plaintiff in part. Cal Fed is entitled to the transaction costs of replacing goodwill, but those transaction costs are derived from raising money in the capital market, not from flowing down money from

the holding company. It does not matter whether plaintiff chose to transfer the needed capital from its holding company or raised it in the capital markets.

A. Flow-down from the Holding Company

In 1989 and 1990 Cal Fed's holding company transferred over $200 million to Cal Fed. Plaintiff argues that this flow-down was planned prior to FIRREA and was intended to give Cal Fed a 2% cushion over the federal capital requirement. Plaintiff states that it was Cal Fed's policy to have such a cushion. The Government contends that this flow-down replaced the phased out goodwill and that there were minimal transaction costs involved with this flow-down because Cal Fed merely took money from one pocket and placed it in another pocket.

The purpose of this flow-down is irrelevant. The Government's breach resulted in the elimination of Cal Fed's supervisory goodwill. Cal Fed is entitled to what it would cost to replace that goodwill in the capital market. The Govern-

ment is responsible for the cost of replacing goodwill with new capital, not with Cal Fed's own assets.

B. Cost of Replacing Goodwill with New Capital

Cal Fed raised a significant amount of new capital through a series of financial transactions. These include a restructuring in 1992, a convertible preferred stock offering in 1993, and a rights offering in 1994. These were the first three capital transactions after the breach occurred. Plaintiff's expert, Professor Pfleiderer used these market transactions to calculate the cost of replacing goodwill. We have used this model for determining the cost of replacing goodwill with new capital raised in the capital market. These ventures raised more than $400 million in capital, an amount sufficient to replace the $390 million in goodwill that Cal Fed had to discount.[13]

The costs of these transactions are the damages suffered by Cal Fed from the Government's breach. These are flotation costs, including fees for underwriters and lawyers. Any amounts greater than these expenses would be more than necessary to make Cal Fed whole; we are not permitted to award them.

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[13] According to defendant the 1992 restructuring raised approximately $151 million in new capital for Cal Fed, the 1993 convertible preferred stock offering raised approximately $89 million in new capital, and the 1994 rights offering raised approximately $183.3 million in new capital. Plaintiff's expert testified that the 1992 restructuring raised $151 million in new capital, the 1993 convertible preferred offering raised $93.5 million, and the 1994 rights offering raised $194.8 million in new capital. The difference appears to be that defendant netted out the transaction costs.

One of plaintiff's experts testified that the cost of replacing $390 million of goodwill--an accounting entry with no value other than to keep regulators at bay--was nearly a billion dollars. We could not determine that such testimony was credible. These inflated costs arose partly from the theoretical repurchase of all outstanding stock by the bank to eliminate the cost of paying dividends.

The Government's expert witness on the matter, Dr. Miller, a Nobel prize winning economist, explained that such a theory is absurd. He testified that in finance, you take the cost of issuing stock the day it is issued. On the day stock is issued, the amount you receive for the stock is equivalent to its worth and the only costs are transaction, or flotation costs. Dr. Miller also points out that raising capital had benefits for Cal Fed beyond merely replacing supervisory goodwill. For example, new capital allowed for investment and risk sharing.

Plaintiffs are entitled to transaction costs determined by the costs of the 1992 restructuring, the 1993 convertible preferred stock offering, and the 1994 rights offering. These three transactions raised enough capital to replace the supervisory goodwill taken away by FIRREA. We believe that this model represents the real cost of defendant's breach to plaintiff.

The costs that comprise this judgment include costs incurred by both Cal Fed and its holding company. Defendant argues that only the costs incurred by Cal Fed should be included. The Government treated the two entities as the same, however. It argued that transferring money from the holding company to the bank was "taking money from the left pocket and putting it in the right pocket." In any event, the holding company merged into the bank. Defendant's expert calculates the transaction costs for the 1993 convertible preferred stock offering at $4.5 million and the transaction, costs for the 1994 rights offering at $11.7 million. Plaintiffs witness,

Mr. Wallis, is in agreement more or less. He testified that the exact transaction costs were $4,298,519 and $11,514,778, respectively.

Transaction costs necessary to raise enough new capital in the capital market to replace goodwill total $22,966,523.42. These are plaintiff's damages.

CONCLUSION

This case has been difficult to analyze in the context of normal common law damage theories. The parties essentially contracted to call liabilities "assets" and used them to improve the bank's apparent health. It was really an agreement by the Government that its regulators would not write up the bank for weak capital ratios if the bank would take on net liabilities from failing thrifts. In fact, all that we could determine from witnesses on both sides concerning the value of this contract was "it would help keep the regulators off our backs."

We expected to find out-of-pocket expenses or other real losses from this breach. But testimony over a period of six weeks from expert witnesses and from the fact witnesses whom we found to be persuasive, did not establish that this plaintiff was damaged in any normal, legal sense of the term. Only a form of disgorgement theory would permit us to award substantial damages to plaintiff in this case. That is, the United States received immediate benefit from the contract measured by the net liabilities assumed by plaintiff on the day that the contract was signed, and plaintiff is awarded that amount. This would not take into consideration anything that happened during the seven years that the contract was performed by both parties. Such damages would be punitive, and that is not the purpose of contract remedies. Moreover, they would not be representative of the relationship between the contracting parties. They would not have been foreseeable. They would be an impermissible windfall to plaintiff.

The United States temporarily transferred its responsibility for the net liabilities of certain failing thrifts to plaintiff; that is true. But it remained responsible for those liabilities as if the contract never had been executed. Were it not for falling interest rates, the United States probably would have had to make those liabilities in the form of deposits good. Plaintiff benefitted from the fortuity of falling rates as did the United States. Credible expert testimony established that plaintiff would not have survived further increases in interest rates during those years. In fact, we determined that further increases in rates would have been calamitous to the entire industry. It is very likely that practically all thrifts would have failed. Defendant argues that regulators were merely "buying time" by their negotiations with relatively healthy thrifts, putting them together with those that were failing. They were betting that rates would come down and everyone would survive without having to tap the insurance fund. This argument may sound unlikely, but no one testified credibly of any other purpose that seemed logical.

The facts of this particular case do not establish that plaintiff suffered monetary loss beyond its expenses of raising new capital to replace the phased-out goodwill. Damages are determined by the value of what it would have cost plaintiff to replace the goodwill on the open market. That amount is $23,353,226.42.

The Clerk will enter judgment for plaintiff in the amount of $23,353,226.42. No costs.

APPENDIX C

IN THE UNITED STATES COURT
OF FEDERAL CLAIMS

* * * * * * * * * * * * * *

CALIFORNIA FEDERAL BANK, A Federal Savings Bank,

Plaintiff,

v.

UNITED STATES OF AMERICA,

Defendant.

No. 92-138 C

Filed: May 6, 1999

* * * * * * * * * * * * * *

ORDER

Plaintiff's motions have no merit. "Cal Fed notes that the Court's April 16, 1999 Opinion . . . erred in failing to adopt the clearly established facts and legal points set forth in Cal Fed's prior written and oral submissions to the Court, including in Cal Fed's prior briefs, its closing and opening arguments, and the evidence presented as part of the trial." This exposes a misunderstanding on plaintiff's part concerning the responsibilities of a trial court. A court cannot merely accept one party's views of a case.

Dean Fischel's testimony in another case, presumably addressing entirely different facts, is not of concern to this

court. It is not our responsibility to examine facts and evidence presented in someone else's case to determine whether they have relevance here. Dean Fischel was a credible expert witness in the trial that we conducted.

A review of Mr. Buting's testimony as a whole will support the court's findings on the issue of regulatory assessments. Mr. Buting testified that from the perspective of the regulators, "no value [was placed] on goodwill." He stated that goodwill "doesn't provide any cushion to protect against losses." When asked whether Cal Fed was required to pay a higher assessments due to the phase-out of supervisory goodwill, Mr. Buting replied, "[d]ue to the phase-out, no. Assessments are based on the overall composite rating of the institution, . . . [i]t's an overall reflection of the rating of the institution." Mr. Buting's testimony was credible.

We found that Cal Fed is entitled to "[t]ransaction costs necessary to raise enough new capital in the capital market to replace goodwill." Plaintiff may have misapprehended the point of the model that we used to calculate that judgment. We used its costs of raising money in the stock offerings post-breach as a reasonable estimate of what such costs would be. Plaintiffs might have raised the money in some other way; it does not mtter for the purposes of this opinion. In that sense, this was a jury verdict judgment, as plaintiff now urges upon the court.

"[E]ven if the Opinion's legal standard for lost profits were correct (and it is not), under that standard, it was still error, at a minimum, to dismiss without a trial Cal Fed's lost profits claims . . . ." (parenthetical phrase in the original). Plaintiff disagrees with the court's ruling of law. It should address that matter to the Court of Appelas for the Federal Circuit.

We did not rule that *Neely I, Neely II,* or *Chain Belt* require "exact" or "precise" information specifying assets

loss. That is not the law. We described the detailed evidence that was availble to those courts, which are among the very few that have granted lost profits against the Government. The comparison of those cases with plaintiff's speculative and hypothetical arguments in *Cal Fed* is striking.

Plaintiff's testimony and evidence concerning the sale of its Southeast franchise conflicted with sworn testimony in another action and otherwise was not credible. For example, plaintiff argued that it sold Southeast as a result of the breach, yet Cal Fed testified to the contrary in a contract dispute with NationsBank of Florida.

Plaintiff complains about the court's "conclusory statements." The job of a trial court is to make conclusory statements. A trial court makes conclusions of fact based on testimony and other evidence that it finds credible. If plaintiff finds our conclusions to be "vague, ambiguous, incomplete, and contrary to clearly established facts and law," such arguments should be made to the Federal Circuit. Plaintiff's argument that the trial court's opinion is "permeated with legal errors" and similar criticisms should be made to the Federal Circuit as well.

All pending motions are DENIED. Cal Fed's Motion for (1) Amended and Additional Findings under RCFC 52(b), (2) Reconsideration or a New Trial under RCFC 59(a)(1), (3) Opening the Judgment under RCFC 59(a)(1), (4) Alteration and Amendment of the Judgment under RCFC 59(d), and (5) Relief from the Judgment under RCFC 60(b)(2), (6) is DENIED. The record of this trial is closed.

/s/
Robert H. Hodges, Jr.
Judge

APPENDIX D

IN THE UNITED STATES COURT
OF FEDERAL CLAIMS

* * * * * * * * * * * * * *

CALIFORNIA FEDERAL BANK,
A Federal Savings Bank,

Plaintiff,

v.

UNITED STATES OF AMERICA,

Defendant.

No. 92-138 C

Filed:
April 21, 1999

* * * * * * * * * * * * * *

ORDER

The following sentence was dropped from the April 16 Opinion, at the end of the last paragraph on page 32: "The 1992 restructuring resulted in $7,153,226.42 in transaction costs." The judgment entered for plaintiff on page 34 is $22,966,523.42. The Clerk will VACATE the judgment entered on April 19 and enter judgment for plaintiff in the amount of $22,966,523.42. No costs.

/s/
Robert H. Hodges, Jr.
Judge

APPENDIX E

IN THE UNITED STATES COURT
OF FEDERAL CLAIMS

* * * * * * * * * * * * * *

CALIFORNIA FEDERAL BANK,
A Federal Savings Bank,

Plaintiff,

v.

UNITED STATES of America,

Defendant.

LANDMARK LAND COMPANY,
INC.,

Plaintiff,

and

FEDERAL DEPOSIT
INSURANCE CORPORATION,
as Successor to the Rights
of Oak Tree Savings Bank,
a State Savings Bank,

Plaintiff Intervenor,

v.

*

* Nos. 92-139 C,
95-502 C,
92-652 C,
90-981 C

* Dec. 22, 1997

THE UNITED STATES, *

Defendant. *

LaSALLE TALMAN BANK, F.S.B., *

*

Plaintiff, *

*

v. *

*

THE UNITED STATES, *

*

Defendant. *

*

C. ROBERT SUESS, *et al.*, *

*

Plaintiffs, *

*

v. *

*

THE UNITED STATES, *

*

Defendant.

* * * * * * * * * * * * * * *

Steven S. Rosenthal, Morrison & Foerster, Washington, DC, for plaintiff in No. 92-138C.

Paul M. Fish, Modrall, Sperling, Roehl Harris & Sisk, Albuquerque, NM, for plaintiff in No. 95-502C.

Richard S. Gill, Federal Deposit Insurance Corporation, Washington, DC, for plaintiff intervenor in No. 95-502C.

Wilber H. Boies, McDermott, Will & Emery, Chicago, IL, for plaintiff in No. 92-652C.

Don S. Willner, Don S. Willner & Associates, Portland, OR, for plaintiffs in No. 90-981C.

Charles J. Cooper, Cooper & Carvin, Washington, DC, Steven S. Rosenthal, and Melvin C. Garbow, Arnold & Porter, Washington, DC, filed supplemental briefing on common issues on behalf of Plaintiffs Coordinating Committee.

John V. Thomas, Associate General Counsel, Federal Deposit Insurance Corporation, Washington, DC, filed supplemental briefing on common issues on behalf of plaintiff FDIC.

Lee M. Straus, Department of Justice, Washington DC, for defendant in No. 92-138C.

Thomas O. Mason, Department of Justice, Washington, DC, for defendant in No. 95-502C.

Charles R. Gross, Department of Justice, Washington, DC, for defendant in No. 92-652C.

Robert E. Leidenheimer, Jr., Department of Justice, Washington, DC, for defendant in No. 90-981C.

David M. Cohen, Director, Jeanne E. Davidson, Assistant Director, Commercial Litigation Branch, Civil Division, and Frank W. Hunger, Assistant Attorney General, Department of Justice, Washington, DC, filed supplemental briefing on common issues on behalf of defendant.

OPINION

SMITH, Chief Judge.

It is the obligation of the United States to do right. Every free government can be judged by the degree to which it respects the life, liberty and property of its citizens. The United States stands tall among the Nations because it is a

just Nation. In the instant cases the United States has not acted in a manner worthy of the great just Nation it is. Because the dollars at stake appear to be so large the government has raised legal and factual arguments that have little or no basis in law, fact or logic.

While the court can appreciate the concerns of the government's attorneys to protect the public treasury, and they are honorable people, it must severely criticize the tactics and approach of the government in these motions for summary judgment.

When the plaintiffs asked the court to hear oral argument on issues applicable to many cases the government opposed the idea, arguing that each case was unique and that the cases did not present common issues conducive to resolution in such a fashion. The recent hearing and briefing in these cases abundantly demonstrate that the government's assertions were and are wrong. They also demonstrate that the fear of the plaintiffs--that the government wants to relitigate the core Winstar liability issues in every case--seems quite justified. This does no credit to the United States.

If the arguments put forth here are the strongest the United States can muster against liability then the government has a moral obligation to seek a fair and equitable settlement from the parties whose contracts were breached. If this cannot be achieved then the court is here to resolve these cases. However, the court is a tool of last resort. Where the government has violated rights it should first attempt to do justice without judicial prompting.

Maybe these ideas are old-fashioned, but they strike the court as particularly applicable to a department that bears the sacred name of Justice. It takes courage to make decisions that may require the government to pay huge sums of money to injured parties. The Civil Division is led by attorneys who have both courage and honor. The history of our law is

written in the heroic actions of attorneys who cared more for justice than advantage. It is the court's hope that following this decision the Winstar cases are either settled or litigated on a serious level.

The cases at bar are four of more than 120 cases which have been identified by the court as raising issues similar[1] to those raised in *Winstar Corporation v. United States* (90-8C), *Glendale Federal Bank v. United States* (No. 90-772C) and *Statesman Savings Holding Corp., et al. v. United States* (90-773C), which were the subject of the United States Supreme Court's decision in *United States v. Winstar*, 518 U.S. 839 (1996), *aff'g* 64 F.3d 1531 (Fed. Cir. 1995), aff'g 21 Cl. Ct. 112 (1990). The Court in *Winstar* affirmed the decision of the Federal Circuit and this court that the government had entered into binding contracts to treat supervisory goodwill as regulatory capital for the contractually prescribed amortization period and that it breached those contracts. *Id.* at ----, ----, ----, 116 S. Ct. at 2452, 2453, 2472.

Even before the Supreme Court handed down its decision in Winstar, this court was aware of significant and unique case management problems these cases would pose

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[1] Rule 77 of the Rules of the United States Court of Federal Claims (RCFC) requires that counsel shall file, at the time a complaint is filed, a Notice of Related Case(s), stating whether there is any pending or previous action in any court or board of contract appeals and whether that action and the instant action: (A) "arise from the same or substantially identical transactions happenings or events"; (B) "call for determination of the same or substantially identical questions"; or (C) are "likely for other reasons to entail substantial duplication of labor if heard by different judges." RCFC 77(f). The cases were identified as related by the parties under this Rule.

irrespective of what the Supreme Court decided on liability in the lead cases. Action in those cases identified as "*Winstar*-related" had been stayed pending appellate resolution of the core liability issues. Many of these cases were quite old, and some had been filed more than six years earlier. In addition, the "*Winstar*-related" cases were not identical, and resolution of all the cases would probably not turn on a single issue of law the determination of which would dispose of all the stayed cases. Rather, the cases involved individually negotiated contracts with unique fact patterns. Further, the pending Supreme Court decision on liability would not resolve the issue of damages if liability were found. Thus, there would possibly need to be additional, and presumably fact intensive, litigation to resolve damages issues.

As a final group of factors indicating the management challenges, these cases were being handled by a large number of law firms and several hundred attorneys on the plaintiffs' side. Collectively plaintiffs in these cases are seeking contract damages in the range of tens of billions of dollars. The 120-plus cases involve several hundred mergers and hundreds of institutions. The parties include functioning banks and thrifts, holding companies, a large number of former stockholders of failed and seized thrifts, and individuals who allege that they directly contracted with the government. A number of the cases had prior litigation histories in United States district courts across the country. Lastly, following the Supreme Court affirmance the Federal Deposit Insurance Corporation (FDIC) moved to intervene as a party plaintiff in about 50 of the cases.

All these factors argued for adopting some form of coordinated case management procedure to deal with these cases, at least initially, as a common group. *See, e.g.*, 35 Fed. Cl. 707 (May 31, 1996 Order); July 8, 1996 Order; August 20, 1996 Order; August 28, 1996 Order. The goal of this

common management was two-fold. One goal was to insure that the Winstar-related cases could be managed as efficiently as possible with a fair opportunity for all plaintiffs to present their cases while minimizing the onerous litigation and discovery burdens facing the government. A second goal was to insure that the Winstar-related cases received an appropriate share of the court's resources, but did not unduly burden the court's ability to manage the other cases on the docket. The Justice Department, which defends the United States in all cases before this court, also recognized the potential problem and prior to the Supreme Court decision had requested that the court adopt special case management procedures in the Winstar-related cases.

The court held an initial status conference on the government's motion for special case management procedures to which all plaintiffs' counsel were invited. A couple of hundred counsel appeared. There was a general consensus that some special procedures were needed, though there were wide differences among counsel and between plaintiffs and the defendant on what procedures to adopt. From the start, one area where the court particularly believed and still believes that real benefits in efficiency, fairness and uniformity could be achieved is through the use of special procedures to identify and resolve issues common to many cases.

This group of four cases presents such a significant opportunity. That is why the court used break time in August, between the plaintiff's and the defendant's cases in the *Glendale* trial, to hear two days of oral argument in these four cases. This argument was accompanied by extensive briefing. It was also the understanding of the court that these four cases raise issues that are potentially relevant in a large number of the pending *Winstar*-related cases. This was a point of contention between the plaintiffs and the defendant, with the government objecting to the format on the grounds

that there were essentially no common issues that could be resolved in such a fashion. The court resolved the dispute in favor of the effort. If it did not succeed in resolving any common issues that had applicability to other *Winstar* cases, at worst it would resolve the issues in these four cases. At best it had the potential to resolve multiple issues and conserve considerable resources for the court and the parties. This is the reason for the hearing and this opinion. As noted in the introduction of this section the plaintiffs' proposal was quite justified.

Before proceeding to the merits of the specific motions at issue here it is relevant to set out the rest of the case management system from which this hearing and opinion originate. The court understands that any system of complex case management depends upon the willingness of the parties to work toward the common goal of rationalizing the process, which requires a recognition of the common and divergent interests of the various plaintiffs and defendant. Here both sides clearly had a common interest: reducing litigation and discovery costs. Plaintiffs had the additional strong interest in obtaining judgments as quickly as possible. Defendant had the additional interest in having to allocate common litigation resources and personnel over all these cases, while still defending the government in the remaining approximately 2000 cases on the court's docket.

Central to the success of these case management procedures is the participation of the three coordinating committees, representing the private plaintiffs, the FDIC, and the defendant, which meet with the court monthly or as needed, to give the court the committees' views on case management issues. The court appreciates the efforts of the counsel who make up the three coordinating committees. The court particularly appreciates the effort of Mr. Stephen D. Susman, who on a *pro bono* basis served as Special Counsel to the court in the months that immediately followed

the Supreme Court's decision in Winstar, and who undertook the task of organizing the plaintiffs into a coordinating committee that could then work with the government to help the court manage this litigation efficiently. This complex organizational task was completed very successfully and to everyone's benefit. The coordinating committee meetings have been open to all parties, on the record, and highly useful to date. When individual plaintiffs feel that their interests diverge from those of the collective plaintiffs they have come to the coordinating committee meetings to make their specific views known. To date the management system has resulted in the following actions:

1) Entry of the Omnibus Case Management Order (September 18, 1996).

2) Entry of the Master Protective Order (November 22, 1996).

3) Disposition of Statute of Limitations common issue identified in the Omnibus Case Management Order. *See Plaintiffs in Winstar-Related Cases v. United States*, 37 Fed. Cl. 174 (Jan. 7, 1997) (Judge John P. Wiese).

4) Disposition of the Motions to Intervene by the Federal Deposit Insurance Corporation common issue identified in the Omnibus Case Management Order. *See Order Addressing FDIC's Motion to Intervene*, Case No. 90-8C et al. (March 14, 1997) (Judge James T. Turner).

5) Appointment of Judge Christine O.C. Miller to serve as Discovery Judge (May 15, 1997).

6) Entry of Procedural Order No. 1: Master Litigation Plan (August 11, 1997).

7) Entry of Procedural Order No. 2: Master Discovery Plan (August 11, 1997).

On September 18, 1996 the court entered an Omnibus Case Management Order (CMO), which established several initial procedures and which was designed to guide the first stages of the litigation process in the *Winstar*-related cases. One of the most important features of the CMO was the creation of a streamlined summary judgment process. Under the process, plaintiffs could file a "short-form" motion for summary judgment as to two liability issues: (1) Was there a contract and (2) Did the government act inconsistently with the contract. The CMO also provided for plaintiffs a suggested short-form format for presenting this information. In light of the additional burdens that defendant might face as a result of responding to a multitude of these summary judgment motions, defendant was given additional time to respond to these motions. Defendant was required to file an initial response to the motion within 60 days, and a second response within 120 days asserting any defenses relating to liability.

This procedure, which was first negotiated by the parties and then recommended to and implemented by the court, was in the court's view designed to streamline the process for identifying cases where liability was effectively determined by the Supreme Court's decision in *Winstar*. It was the court's hope that the process would work as follows: plaintiffs who believed that the Winstar decision controlled would file the short-form motions which provided the relevant documentation and cited the appropriate authority. Defendant would have ample time to review this documentation and the law to determine whether defendant was liable. If defendant determined that Winstar governed and that liability was established, then those cases could leave the liability track and move to the damages track and ultimate resolution. The court could then work with the

parties to develop procedures to resolve other issues not resolved by the *Winstar* liability decisions.

Since implementation of the CMO, more than thirty plaintiffs have filed motions for summary judgment pursuant to its terms. While the court was hopeful that the procedures in place would expedite resolution of at least the liability issues in a large number of cases, in only one of the cases (*Coast Federal Bank v. United States*, No. 92-466C) where plaintiffs have filed motions for summary judgment has defendant conceded that plaintiff had a contract with the government and the government acted inconsistently with that contract. In all other cases, the government has raised a variety of contract defenses. As a result, the court was faced with a multitude of summary judgment motions which were opposed by defendant. Although defendant believed that these summary judgment motions should be dealt with individually, the court believes that, consistent with the goals of the case management process, the court should attempt to economize the resources of both the court and parties and use special procedures for resolving the summary judgment motions efficiently and expeditiously.

This opinion is the result of that attempt. During the late spring of 1997, Plaintiffs Coordinating Committee (PCC) and the FDIC identified a group of contract defenses raised by defendant in more than one of the Winstar-related case summary judgment motions. The court then selected the four cases at bar for consideration because they would ventilate the broadest cross-section of the contract defenses raised by defendant.[2] While the court was unsure whether this would

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[2] Plaintiffs Coordinating Committee identified 13 common issues it believed were raised in the government's summary

[Footnote continued on next page]

resolve all issues in all pending summary judgment motions, the court believed it merited the effort consistent with the goals of the CMO and subsequent management orders. As noted earlier, this belief was well founded.

These four cases are before the court on the following motions: plaintiff's and defendant's cross-motions for summary judgment as to liability in *California Federal Bank v. United States*; plaintiff's and plaintiff intervenor's motions for summary judgment and defendant's cross-motions for summary judgment as to liability in *Landmark Land Company v. United States*; plaintiff's motion for summary judgment as to liability in *LaSalle Talman Bank v. United States*; and plaintiff's and defendant's cross-motions for summary judgment as to liability in *Suess v. United States*.

The court will briefly discuss the underlying facts in each case, and then will address the relevant issues raised in each case on an issue-by-issue basis.

FACTS

CALIFORNIA FEDERAL BANK v. UNITED STATES
(No. 92-138C)

California Federal Bank, FSB, (CalFed) seeks summary judgment that the defendant breached its contractual obligations to CalFed regarding the treatment of supervisory goodwill with respect to three transactions in 1982 and 1983: 1) CalFed's 1982 acquisition of three Georgia thrifts and a Florida thrift (the Southeastern transaction); 2) CalFed's 1982 acquisition of Brentwood Savings and Loan Association, a California thrift; and 3) CalFed's 1983

[Footnote continued from previous page]
judgment briefing. The four cases at bar involve 11 of the 13 common issues identified by PCC.

acquisition of Family Savings and Loan Association. Defendant makes three arguments supporting its claim for summary judgment: 1) no contract existed between the government and CalFed regarding the Brentwood and Family transactions; 2) although a contract existed with respect to the Southeastern deals, no cause of action lies because CalFed failed to satisfy a "condition precedent" (submission of an accountant's opinion to the Federal Home Loan Bank Board); and 3) because each of the transactions was governed by a "net worth forbearance" letter that expired after five years, and which in all three sets of transactions expired before the passage of the Financial Institutions Reform and Recovery Act (FIRREA) and its implementing regulations, FIRREA and its regulations did not breach any contracts with plaintiff.[3]

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[3] CalFed argues in its brief that defendant should be barred from raising the "net worth forbearance" issue because it failed to raise the issue in its initial 60-day response to plaintiff's motion for summary judgment, in which defendant was required pursuant to the CMO to answer "whether the Government acted inconsistently with [the] contract." Defendant initially raised the issue in its 120-day response. Regardless of the merits of plaintiff's procedural argument, the court will consider the issue for two reasons: it was voluminously briefed in supplemental briefing in *CalFed* and in the supplemental briefing provided by Plaintiffs Coordinating Committee and, as PCC points out, it is an issue that has been raised in more than 10 cases, including another case at bar, *Suess v. United States*.

LANDMARK LAND COMPANY, INC. v. UNITED STATES
(No. 95-502C)

Landmark seeks summary judgment as to liability for defendant's breach of its contractual obligations regarding the treatment of supervisory goodwill regarding two transactions entered into by Landmark in 1982 and 1986.[4] In September 1982 the government approved the merger of Dixie Savings and Loan Association and Heritage Savings and Loan Association (Heritage), and the conversion of both from federal mutual to federal stock form, with Landmark to be the owner of the resultant thrift's (Dixie) newly issued stock. As part of the Assistance Agreement, signed by Landmark, Dixie, and the Federal Savings and Loan Insurance Corporation (FSLIC), the FSLIC made a cash contribution of $21 million in the form of a five-year note. Plaintiff was to contribute $20 million to Dixie's net worth in the form of cash and/or real estate. Section 9 of the Assistance Agreement contained a termination clause, and Section 10 provided for the amortization of supervisory goodwill on a 40-year basis. Defendant contends that it is entitled to summary judgment as to this transaction for several reasons: 1) that the termination clause that governed these transactions expired prior to FIRREA, hence terminating any government obligations that might have existed; 2) that there was no requirement for the government

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[4] The FDIC has filed a motion for summary judgment as successor in interest to Oak Tree Savings Bank, which became the name of the affected thrifts in December 1989, and which was ultimately seized in October 1991. Since the FDIC's motion and plaintiff's motion, and the government's responses, are in all major respects identical, the court will for analytical purposes treat them as one argument.

to permit Dixie to amortize goodwill over forty years, or to count FSLIC and Landmark capital contributions towards net worth beyond the expiration of the Assistance Agreement; and 3) that Landmark failed to satisfy conditions precedent relating to real estate appraisals which are set forth in the Assistance Agreement and in Bank Board Resolution 82-657.

The second transaction involves the acquisition by Dixie of St. Bernard Savings and Loan Association in 1986. St. Bernard was converted into a stock association and acquired by Landmark Land Development Company, a wholly-owned subsidiary of Dixie. Landmark contributed assets totaling $715 million in exchange for the stock, and were granted in a series of Federal Home Loan Bank Board (FHLBB) Resolutions several regulatory forbearances. The government argues in regard to the St. Bernard transaction that no contract with the government was formed.

LASALLE TALMAN BANK, F.S.B. v. UNITED STATES
(No. 92-652C)

In 1982, LaSalle Talman Bank, at the behest of and with the express agreement of the Federal Savings and Loan Insurance Corporation (FSLIC) and FHLBB: 1) merged with Alliance Savings and Loan Association and Northwest Savings and Loan; 2) acquired Unity Savings and Loan, which was in receivership, from the FSLIC; and 3) merged with First Federal Savings and Loan. All relevant documents provided for the amortization of supervisory goodwill over 40 years. In 1986, LaSalle Talman executed a Financing Agreement, including an "Agreement Regarding Goodwill," with the FSLIC. The goodwill agreement provided for a $100 million reduction in total goodwill on plaintiff's books, recognized the remaining goodwill as reflected in plaintiff's financial statements and expressly provided for amortization of that goodwill over a 30-year period. The government argues that the 1982 contracts were superseded by the 1986 agreement, and that, as a result, the enactment of FIRREA

could not have breached the 1982 contract, and that none of the 1986 documents can be read to permit plaintiff the right to use unamortized goodwill to meet regulatory capital requirements.

SUESS v. UNITED STATES
(No. 90-981C)

This case involves two acquisitions by Benj. Franklin Savings and Loan Association (BF) of ailing thrifts. In September 1982, BF merged with Equitable Savings and Loan. In July 1985, BF acquired another failing savings and loan, Western Heritage. Additionally, BF converted from a federal mutual to a federal stock association in December 1986, and the amortization period for the goodwill recognized on its books from the Equitable merger was changed from 40 to 25 years. Defendant challenges the existence of a contract relating to the Equitable merger, and also challenges plaintiffs' reliance on affidavits as part of its motion to establish contractual intent. Regarding the Western Heritage acquisition, the government contends that BF failed to meet a condition precedent (requiring BF to submit an independent accountant's opinion letter to the Bank Board); that the five-year net worth forbearance trumps any contractual language suggesting that goodwill could be amortized for a period longer than five years; and that the capital credit attributable to net worth expired at the same time as the five-year assistance agreement.

DISCUSSION

Following the format set forth in the Plaintiffs Coordinating Committee's brief and Defendant's response, the court will address each common issue in turn.

ISSUE No. 1

Relevant to: *CalFed*, *Suess*

> Statement of issue: The existence of a five year agreement protecting against the seizure of the thrift for any reason related to a supervisory acquisition establishes that the government's agreement to a 25-or-more year capital contract was, in fact, only a five year agreement, and the government is bound to honor the capital contract for only five years.
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> * * *

Plaintiffs make three basic arguments in response to this general assertion by the government. First, "[t]wo of the three *Winstar* test cases, Statesman and Glendale, involved forbearance letters issued by the FHLBB that contained net worth forbearances similar, if not identical, to those now at issue." Pls. Cmte Brief, CI # 1, at 6 (citing *Statesman Savings Holding Corp. v. U.S.*, 26 Cl. Ct. 904, 910 (1992)). The Supreme Court affirmed the findings by this court and the Federal Circuit that contracts allowing amortization of goodwill over the longer (20-40 year) periods existed and were breached by FIRREA and its regulations. Second, "[t]he government has provided no basis for reinterpreting those promises to render the promise regarding supervisory goodwill largely insignificant and useless." *Id.* at 8. The proposition that a contract must be interpreted to give meaning to all of its provisions is a fundamental rule of contract interpretation; thus, the government's reinterpretation must be rejected. *Id.* at 7 (citations omitted). Third, the various parties' course of conduct prior to FIRREA establishes that the government ratified the plaintiffs' recording of supervisory goodwill and "amortizing it according to the promises that the government now says did not exist." *Id.* at 13. Only in several of its 120- day responses, filed this year, has the government ever suggested that net worth forbearances trumped the supervisory goodwill commitments.

The evidence presented by the *CalFed* and *Suess* plaintiffs strongly support Plaintiffs' argument. CalFed would not have sought a separate net worth forbearance one year after its acquisition of the Southeastern thrifts and the goodwill forbearance issued in connection therewith unless the commitments were complementary. CalFed Reply at 11 & n. 7. It would have been irrational to bargain away a 35 year amortization of goodwill that CalFed had bargained for in return for a 5 year period. CalFed has also submitted the testimony of Dr. D. James Croft, who served as Director of FHLBB's Office of Examinations and Supervision, stating that net worth forbearances "were frequently granted in supervisory mergers and were intended to deal with different issues and to provide distinct inducements separate from the agreements regarding purchase accounting and regulatory treatment of goodwill." CalFed Reply, Croft Decl. at ¶ 21. CalFed regularly submitted quarterly financial reports to the FHLBB, after the expiration of the five year net worth forbearances, that recorded supervisory goodwill as regulatory capital. CalFed Reply at 12-13. The government did not assert, prior to 1997, that the inclusion of such supervisory goodwill was barred by the expiration of the net worth forbearances.

The government's arguments in Suess[5] fare no better than those in CalFed. First, a May 6, 1985 letter from the Seattle FHLBB to Mr. G. Dale Weight (CEO of Benj. Franklin S & L, of which Suess plaintiffs are shareholders), "offering a written synopsis of our agreement as we see it,"

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[5] The government makes its Common Issue # 1 argument with respect to Benj. Franklin's acquisition of Western Heritage S & L in 1985. The government does not make this argument with respect to BF's 1982 merger with another failing bank, Equitable S & L.

states that "[t]he Accounting Forbearances are allowable and, therefore, accepted." Suess Pl.App. at 230. The forbearances referred to were contained in an April 17, 1985 proposal letter from Benj. Franklin to the Seattle FHLBB. Under the heading "Forbearances," upon which the transaction was made "contingent," the letter stated that "[a]ssets acquired by Benj. Franklin from Western Heritage will be deemed to have been acquired in a 'merger instituted for supervisory reasons.'" *Id.* at 220. In the next paragraph under the same heading, the five year forbearances were listed and discussed. *Id.* A separate heading, "Accounting Forbearances," appears several pages later (following a brief section on tax implications). Under this heading, Benj. Franklin "respectfully requests that the following accounting forbearances be granted it for regulatory accounting purposes, subsequent to the merger with Western Heritage." *Id.* at 223. These forbearances are listed:

> 1. That the FSLIC assistance received be credited directly to net worth rather than being treated as an adjustment of the purchase price as required by G.A.A.P. [Generally Accepted Accounting Principles]
>
> 2. Discounts on loans to be amortized over 15 years by the level-yield method rather than over the contractual loan life adjusted for expected prepayments as required by G.A.A.P.
>
> 3. The entire value of intangible assets created by applying the purchase method of accounting be amortized over 40 years by the straight-line method.

Suess Pl.App. at 223. The Seattle FHLBB accepted these accounting forbearances in its May 6, 1985 letter. These accounting forbearances were entirely separate and not

contingent upon the forbearances concerning the FSLIC insurance regulations that were to expire after five years.

Second, a July 15, 1985 interoffice memo from Mr. James R. Faulstich, FHLBB Principal Supervisory Agent to the FHLBB not only recognized that Benj. Franklin had amortized $329 million of goodwill up to December, 1984, but confirmed that:

[T]he following accounting treatment has been requested for regulatory reporting purposes:

> (B) The value of intangible assets resulting from application of the purchase method of accounting will be amortized to expense by the straight-line method over a period not to exceed 40 years . . . . Benj. Franklin has indicated that without the authorization of such accounting treatment, it would be disinclined to proceed with the transaction. Accordingly, the Supervisory Agent has no objection to such accounting treatment for purposes of regulatory reporting only.

Suess Pl.App. at 238. In the same memo, under a separate section labeled "Requested Forbearances," Faulstich discusses the five year forbearances to be granted under the FSLIC insurance regulations. This memo constitutes further evidence that the forbearances granted concerning the latter regulations were independent of the accounting treatment of goodwill that the FHLBB understood to be a sine qua non of the Western Heritage acquisition.

Finally, the Assistance Agreement between the FHLBB and BF, at Section 10, states:

> Except as otherwise provided, any computations made for purposes of this Agreement shall be governed by [GAAP] as applied in the savings and loan industry,

> except that where such principles conflict with the terms of the Agreement, applicable regulations of the Bank Board or the CORPORATION, or any resolution or action of the Bank Board approving or relating to the Merger or to this Agreement, then this Agreement, such regulations, or such resolution or action shall govern.

Id. at 279. The Agreement's integration clause, at Section 16, states that the Agreement "supersedes all prior agreements and understandings of the parties in connection with it, excepting only the Merger Agreement and any resolutions or letters concerning the Merger or this Agreement issued by the Bank Board . . . ." *Id.* at 283. The Merger Agreement, *see id.* at 292, affirms the 40 year amortization of regulatory goodwill, and in so doing corroborates the understandings of the parties as manifested in the letters referenced above.

Under such contractual circumstances, the remainder of Defendant's arguments concerning the net worth forbearances and whether they were breached are completely irrelevant. *See* Def. Cross-Mot. & Opp'n (Suess) at 81-85. A contract did exist concerning the amortization of regulatory goodwill, and its existence did not depend in any way upon the separate net worth forbearances granted amongst the same contractual documents. FHLBB Resolution 85-618, Suess Pl.App. at 292 ("the value of any intangible assets acquired as a result of the Merger may by amortized by [BF] over a period of forty (40) years by the straight line method"). *Accord*, *Winstar*, 518 U.S. at ---- -----, 116 S. Ct. at 2442-43. Consistent with the initial assertions of the PCC, the government's position on this issue seems a clear attempt to relitigate the Supreme Court, the Federal Circuit, and this court's decisions in the original Winstar cases.

ISSUE No. 2

Relevant to: *Landmark, Suess*

> Statement of Issue: Where the government has provided a 25-or-more year capital contract, but where the assistance agreement [AA] providing for cash payments terminates in five years, the five year termination provision pretermits the 25-or-more year capital contract such that the government is bound to obey the capital contract for only five years.
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> * * *

Plaintiffs argue generally that "this exact issue was raised, and disposed of, in the Winstar test cases." Pls. Cmte. Brief, CI # 2, at 2. The "termination clauses" at issue employ similar or identical language.[6] In fact, Section 9 of the AA was the agreement's termination clause, identical in all respects to those contained in the Statesman, Winstar, and Suess (Western Heritage) assistance agreements. *See* Plaintiffs Coordinating Committee Brief, CI # 2, Apps. A, B.

With respect to Landmark, the government argues that "any contractual obligation to permit the FSLIC assistance to be counted as a contribution to Dixie's net worth, or to permit any particular treatment of real estate contributions

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[6] In Landmark, the relevant clause in the Assistance Agreement executed in connection with Landmark's 1982 acquisition Dixie S & L reads (in part):

Except as otherwise specifically provided, this Agreement shall terminate five years following the Acquisition Date or on such other date to which the parties or their successors agree in writing . . . . Pls. Cmte Brief, CI # 2, at App. A. [Landmark 1982 Assistance Agreement, § 9].

from Landmark, clearly expired with the Assistance Agreement." Def. Cross-Mot. & Opp'n (Landmark) at 11. Further, based on AA § 9, Defendant reads the "contract" to have permitted Dixie to "continue to count [supervisory goodwill] as regulatory capital, and to use a 40 year amortization schedule [ ], during the term of the agreement [five years]." *Id.* at 14. The plaintiffs respond that: "[T]here is no dispute that the government vigorously asserted this termination argument in the *Winstar* test cases, alleging that the validity of any promises that might have been made lapsed when the relevant [AA] terminated." Pls. Cmte. Brief, CI # 2, at 4-5 (citing Landmark Pl. Reply at 5-7 (quoting government briefs and oral argument in the Federal Circuit and Supreme Court)). Indeed, the Federal Circuit found the government's termination clause arguments "unpersuasive," stating that the expiration provisions applied only to the "executory provisions set out in the SAA . . . ." *Winstar*, 64 F.3d at 1544, 1542.[7] Landmark points out correctly that the Supreme Court could not have affirmed the existence of contracts with respect to amortization of goodwill or the counting of capital credits towards net worth without rejecting Defendant's termination clause arguments. Landmark Pl. Reply at 7 & n. 5 (quoting *Winstar*, 518 U.S. at ----, 116 S. Ct. at 2451). Also, Landmark points out that "[g]iven the fundamental goals and basic intentions of the parties to the Assistance Agreement, it would have been no more possible for Landmark to withdraw its real estate contributions after five years than for Defendant to back out

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[7] "We view the expiration provisions as only relating to executory provisions set out in the SAA . . . [t]his provision of the SAA does not negate other obligations under the merger plan, including the specific time periods for the amortization of goodwill." *Winstar*, 64 F.3d at 1542

of its commitments concerning accounting methodology and to promote real estate development opportunities."[8] Landmark Pl. Reply at 18.

The government attempts the same argument in Suess to rebut Plaintiffs' assertion that Defendant breached its obligation to treat the $8.8 million cash contribution from FSLIC to BF as a credit to BF's net worth. Def's Cross-Mot. & Opp'n (Suess) at 86. Here, the termination clause is set forth at Section 13 of the Western Heritage Assistance Agreement.[9] Plaintiffs common issue brief attaches copies of the relevant sections of the *Winstar* and *Statesman* Assistance Agreement termination clauses. *Id.*, Pls. Cmte. Brief CI # 2, at Appx. A, B. These are identical, except for the term of years (two years in Winstar, five in Statesman, three here). As the Western Heritage documents demonstrate, there is no reason to treat the Western Heritage

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[8] *See* Landmark AA § 17: "It is the purpose of this Agreement to provide a means by which the failures of the MERGING ASSOCIATION and the RESULTING ASSOCIATION may be prevented . . . and the RESULTING ASSOCIATION [ ] may be provided with property development and loan portfolio opportunities. [ ]. [I]t is intended that the purposes of this Agreement be accomplished without imposing an unreasonable financial burden on the RESULTING ASSOCIATION." Landmark Pl. Mot. Summ. J. at Ex. A. "Likewise, it would have been 'madness' for Landmark to contribute all real estate assets--with projected development over a 20 year period--only to have that value cancelled after a few years." Landmark Pl. Reply at 20.

[9] Section 13 states that "[e]xcept as otherwise specifically provided in this Agreement, this Agreement shall terminate three (3) years following the Effective Date [July 31, 1985]."

termination clause differently from those considered by the Federal Circuit and the Supreme Court.

In *Suess*, the government's agreement to provide a cash contribution to BF to facilitate the Western Heritage acquisition dates from the Seattle FHLBB letter of May 6, 1985, offering an $8.8 million figure instead of the $9.5 million BF suggested in its proposal of April 17, 1985. Suess Pl.App. at 225, 230. As in *Statesman*, the Assistance Agreement in this case "contained express terms that allowed capital credits to be used to satisfy regulatory capital." 64 F.3d at 1542. In *Statesman*, 26 Cl. Ct. at 916, this court could not "find any reason for treating capital credits differently than supervisory goodwill" and concluded that "the government is liable to Statesman for its decision not to honor either of these promises." The government's position is that the $8.8 million capital credit could only be treated as such for three years. Thus, by the time BF was "placed into conservatorship in February 1990, Franklin had no contractual entitlement to count the FSLIC's $8.8 million cash contribution as a credit to its net worth." Def. Cross-Mot. & Opp'n (Suess) at 87. The government's argument must fail as it is inconsistent with the law set forth in the previous considerations of this very same issue by the Supreme Court and the Federal Circuit.

Benj. Franklin, in its April 17, 1985 proposal letter, submitted "Bid No. 1," which stated that "[i]n order to make this merger possible and affordable, The Benj. Franklin seeks from the FSLIC a cash contribution in an amount of $9,500,000 to be paid in full promptly after closing." Suess Pl.App. at 225. In its May 6, 1985 acceptance and amendment of BF's proposal, the FHLBB stipulated that "the amount of cash assistance requested as part of 'Bid No. 1' has been lowered to $8.8 million." *Id.* at 230. In other words, the terms of the proposal that set forth the requirement of "paid in fill promptly after closing" remained

unvaried by FHLBB's acceptance of the proposal. BF's proposal also made clear to the FHLBB that the cash contribution was essential to the transaction. FHLBB-Seattle President Faulstich's July 15, 1985 memo, under the section entitled "Accounting Issues," further states that "[t]he FSLIC cash contribution will be a direct credit to net worth." There is no indication that the FHLBB placed an expiration date on this credit. Further, Section 16 of the Assistance Agreement (the integration clause), which takes into account collateral understandings and documents, would allow the prior understanding of the parties concerning the capital credit to modify the termination clause. Not only is the latter clause non-specific, but the Supreme Court affirmed the Federal Circuit's construction of identical language in the documents examined in those decisions. *See* Pls. Cmte. Brief, CI # 2, at 5-6 ("[A]ny non-executory aspects of the transaction were not affected by the termination clause. Those non-executory aspects included, of course, the promise that allowed Glendale to include in regulatory capital the supervisory goodwill generated by the acquisition."); FDIC Brief, CI # 2, at 4-5 ("If a thrift obtained a right (here, to count goodwill or a capital credit) at the inception of the contract, the fact that different rights (e.g., the right to put bad assets back to FSLIC) terminate after five years is of no moment, since the thrift's rights were already vested.")

Considering the documentary evidence in Landmark and Suess, and the Supreme Court's necessary rejection of the same government arguments in Winstar, Defendant's argument on Common Issue # 2 is meritless and should be rejected.

ISSUE No. 3

Relevant to: Landmark, *Suess*

Statement of Issue: Capital contract fails to satisfy the unmistakability doctrine.

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In *Landmark* and *Suess*, the unmistakability argument plays a minor role among the government's arguments. In *Landmark*, the government asserts this defense in its 120-day filing as part of a general, five item "defense regarding the existence of a contract" list unsupported by any citations to the record. *See* Def. Supp. Filing (Landmark) at 2-3. In *Suess*, the defense is asserted in a footnote to the government's argument that the net worth forbearance afforded as part of BF's acquisition of Western Heritage trumped any provision allowing amortization of goodwill over 40 years. Def. Cross-Mot. & Opp'n. (Suess) at 84 n. 15; *see supra* (rejecting the government's arguments on Common Issue No. 1). Essentially, the government contends that agreements that would allow thrifts to amortize supervisory goodwill over 40 years are voided by the principle that a surrender of the government's power to enforce changes in laws and regulations must be "clear and unmistakable," and the fact that no documents memorializing the *Winstar*-type transactions satisfy that test.[10] Def.'s

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[10] In its Reply brief in Landmark, at 6-10, Defendant proffers another version of the unmistakability argument, namely, that "if an acquiring thrift had other business reasons for acquiring a failing thrift, Defendant's (otherwise binding) promise to permit supervisory goodwill to be counted in computing capital was not binding . . . ." FDIC Brief, CI # 3, at 4. This argument ignores the Supreme Court's finding that the primary motivation to consummate the relevant transactions came from the Bank Board's "plan to avoid the insurance liability." *Winstar*, 518 U.S. at ----, 116 S. Ct. at 2442. The argument also ignores the undisputed fact with respect to the Landmark-Dixie transaction in 1982 that Dixie's negative net worth was over $100 million on the day it was acquired by Landmark. Business considerations notwithstanding,

[Footnote continued on next page]

Cross-Mot. & Opp'n (Suess) at 84 n. 15; Pls. Cmte Brief, CI # 3, at 6.

What the Supreme Court plurality opinion actually stated in Winstar is this: "[T]he government agreed to do something that did not implicate its sovereign powers at all, that is, to indemnify its contracting partners against financial losses arising from regulatory change. We accordingly hold that the Federal Circuit correctly refused to apply the unmistakability doctrine here." *Winstar*, 518 U.S. at ----, 116 S. Ct. at 2461.[11] The three justice concurrence recognized a relevance to the doctrine in these cases but found that the identical contracts in *Winstar, et al.*, clearly satisfied the doctrine. *Id.* at ---- - ----, 116 S. Ct. at 2477-78. Either way, a strong Court majority provides no support for the government's position. Plaintiffs' extensive arguments on this issue (most of which relate to distinctions the government attempts to make in other cases) serve to emphasize the point clearly expressed by the Supreme Court. Pls. Cmte. Brief, CI # 3, at 11-14 (rebutting the government's

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[Footnote continued from previous page]
absent an agreement to amortize that amount of supervisory goodwill, Dixie would immediately have been subject to seizure and subsequent liquidation at FSLIC's cost. *See* Landmark Pl. Reply at 9-10.

11 "To be sure, it might seem unlikely, in the abstract, that the Government would have intended to make a binding promise that would oblige it to hold the thrifts harmless from the effects of future regulation (or legislation) in such a high-risk, highly regulated context as the accounting practices of failing savings and loans. But, as the plurality's careful examination of the circumstances reveals, that is exactly what the Government did." *Winstar*, 518 U.S. at ----, 116 S. Ct. at 2476 (Breyer, J., concurring).

claims that (1) implied contracts must fail under the unmistakability doctrine; (2) successor regulations shift the risk under goodwill contracts to plaintiffs). In Landmark and Suess, the government provides absolutely no factual or legal grounds upon which to base its reassertion of the discredited unmistakability argument.

ISSUE No. 4

Relevant to: LaSalle Talman

> *Statement of Issue*: Fact that capital contract guarantees that thrift may record supervisory goodwill as an asset on its books and amortize it over 25- or-more years does not mean that thrift may include the amount of that goodwill in its calculation of regulatory capital.
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> * * *

The Federal Circuit, discussing the Glendale transaction, "found that guidelines on the purchase method of accounting set out in an internal Bank Board memorandum, to which reference was made in the Resolution, evidenced Defendant's approval of regulatory accounting principles." FDIC Brief, CI # 4, at 3. It thus concluded that there existed "an express contractual obligation to permit Glendale to count the supervisory goodwill generated as a result of its merger with Broward as a capital asset for regulatory capital purposes." *Id.* (citing *Winstar*, 64 F.3d at 1540-41). In its Response to LaSalle Talman's Short Form motion, Defendant "does not concede that the 1986 agreement between the FSLIC and Talman Home created a contractual obligation to permit Talman Home to use unamortized goodwill to satisfy capital reserve requirements for the life of the agreed upon amortization schedule, or for any period of time." Def. Resp. (LaSalle Talman) at 4. FHLBB Resolution 82-110, issued in connection with LaSalle Talman's 1982 transactions, stated that "[i]f Talman Home desires to use the purchase method of

accounting in regard to its acquisition of Unity, and its mergers with North West and Alliance, Talman Home shall submit a stipulation that any goodwill arising from the transactions shall be determined and amortized in accordance with Bank Board Memorandum R-31b." LaSalle Talman Pl. Exh. D, at 3. Bank Board Memorandum R-31b is the same document referred to throughout the *Winstar* litigation as providing for "the use of the purchase method of accounting under which 'supervisory goodwill' resulting from the merger would be treated as satisfying part of the merged thrift's regulatory capital requirements." *Winstar*, 64 F.3d at 1535 (citing the Memorandum). On October 22, 1986, LaSalle Talman executed an "Agreement Regarding Goodwill" with FSLIC providing that "all remaining goodwill of Talman Home shall be amortized over a thirty year period," and that "[n]o change shall be made to the manner in which such goodwill was amortized prior to the Closing Date and each separate component of goodwill shall be amortized after the Closing Date on a straight line basis over the then remaining term of such component's thirty year period." LaSalle Talman Pl. Ex. J., at 1-2.

To summarize: LaSalle Talman was specifically allowed to amortize goodwill from its 1982 transactions and use it in accordance with Bank Board Resolution 82-110 and Memorandum R-31b to satisfy capital asset requirements. The Supreme Court and Federal Circuit affirmed that such agreements were express contractual obligations that permitted thrifts to amortize goodwill and count that supervisory goodwill as capital assets to satisfy regulatory requirements. *See Winstar*, 64 F.3d at 1540, 518 U.S. at ----, 116 S. Ct. at 2449. In 1986, LaSalle Talman executed an agreement with the government confirming the treatment of goodwill that had been agreed upon in 1982. Thus, Defendant's argument on this issue also ignores the core decisions reached by this court, the Federal Circuit, and the Supreme Court in *Winstar*. *See* Pls. Cmte Brief, CI # 4, at 7

("[A]lthough the Supreme Court only specifically addressed three transactions in Winstar, its interpretation of the Bank Board's common plan for dealing with the thrift crisis by inducing healthy institutions to take on failing ones in exchange for help in meeting federal capital reserve regulations should be applied to all transactions that were part of the Bank Board's efforts").

ISSUE No. 5

Relevant to: Landmark

> *Statement of Issue*: Capital contract guaranteeing that acquiror may amortize supervisory goodwill on a 25-or-more year schedule does not constitute a government promise that acquiror may actually amortize goodwill on that schedule for the full 25-or-more years.
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> * * *

In *Landmark*, Defendant argues that "[t]he provision in the assistance agreement upon which plaintiff relies established only that a 40 year schedule could be used to amortize supervisory goodwill, not that the amortization itself would necessarily occur over 40 years." Def. Cross-Mot. & Opp'n (Landmark) at 13. Section 10 of the 1982 Assistance Agreement in *Landmark* states that purchase accounting will govern the computations, accountings, and transactions contemplated by the agreement, including the "amortization of goodwill on a straight-line basis over a period of forty (40) years." Landmark Pl.'s Mot. Summ. J. at Exh. A.[12] The FDIC points out that the similar (if not

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12 Defendant actually argues that, because the forbearance letter (10/1/82) does not mention a specific amortization period, and in a

[Footnote continued on next page]

identical) provisions in the Winstar agreements were construed by the Federal Circuit to permit "the recording of supervisory goodwill as a capital asset for regulatory capital purposes to be amortized over [in Winstar's case] 35 years." *Winstar*, 64 F.3d at 1544; see FDIC Brief, CI # 5, at 4 (citing the language of the Glendale, Statesman, and *Winstar* agreements and their similar disposition by all *Winstar* courts).

Defendant's argument has, again, been litigated and rejected. "[T]he Supreme Court made clear that the specific 'help' it was referring to [the understanding that acquisitions and mergers be subject to purchase accounting] was a commitment to recognize as regulatory capital the supervisory goodwill resulting from purchase accounting of such transactions." Pls. Cmte Brief, CI # 5, at 5-6 (quoting *Winstar*, 518 U.S. at ----, 116 S. Ct. at 2442). The Supreme Court undisputedly concluded that "we do not doubt the soundness of the Federal Circuit's finding that the overall 'documentation in the Winstar transaction establishes an express agreement allowing Winstar to proceed with the merger plan approved by the Bank Board, including the recording of supervisory goodwill as a capital asset for regulatory capital purposes to be amortized over 35 years.'" 518 U.S. at ----, 116 S. Ct. at 2450 (quoting 64 F.3d at 1544). Defendant has not distinguished Landmark's case from *Winstar* in any way. Regulatory "help" that expired with the AA would have made no sense; the goodwill promises must

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separate paragraph states that net worth forbearances will expire after five years, the plain language of Section 10 of the AA does not grant Landmark the contractual rights it claims. Def. Cross-Mot. & Opp'n (Landmark) at 14. For the reasons discussed under Issue I, *supra*, and here, this argument is without merit.

have been durable for the terms set out in Section 10 of the AA, as the plain language therein indicates. *See* Pls. Cmte. Brief, CI # 5, at 7 ("It simply would not have made sense for healthy institutions to have gone to the trouble of negotiating a particular regulatory treatment if that treatment was not guaranteed to last for the specified period of time.").

FIRREA breached Landmark's contract with the government. Defendant should be held liable in all cases in which similar language defined the government's contractual obligation to permit amortization of goodwill over a 25-or-more year time period. In these cases the language is virtually identical or identical to the 3 lead cases. The court is disturbed by the fact that the government makes no serious attempt to distinguish this language. If this is not logically possible, as seems the case, then the defendant is acting unprofessionally in using this argument. It is not a responsible posture to reargue points lost overwhelmingly before all three levels of our federal judicial system.

ISSUE No. 6

Relevant to: CalFed, Suess

> *Statement of Issue*: Fact that a thrift would have been in capital compliance on the date of acquisition without the capital contract per se evidences that no contract regarding capital could have existed.
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> * * *

With respect to *Suess*, Supreme Court's reasoning [in *Winstar*] does not apply to [BF's acquisition of Western Heritage]." Def. Cross-Mot. & Opp'n (Suess) at 83. This is so, according to the government, because "the dollar amount of the Heritage goodwill was insufficient to render Franklin

either in or out of compliance with regulatory capital requirements." *Id.* at 84. Defendant provides no citations to the *Suess* record to support this claim factually.[13] Legally, the government's argument reduces to the equally unsupportable proposition that, absent immediate insolvency, the healthy thrifts would have proceeded with the relevant transactions regardless of the existence of contractual provisions allowing for amortization of supervisory goodwill. *See* Pls. Cmte. Brief, CI # 6, at 6. The Supreme Court recognized that the "realities of the transaction" meant that "it would have been irrational" for the healthy thrifts to agree to acquire failing thrifts absent the contractual guarantee of favorable treatment of the liabilities assumed. *Winstar*, 518 U.S. at ----, 116 S. Ct. at 2449. The Court also recognized that the incentives offered by the Bank Board to the healthy thrifts to proceed with the transactions "consisted principally of promises with respect to the use of supervisory goodwill to satisfy capital requirements." Pls. Cmte. Brief, CI # 6, at 2 (citing *Winstar*, 518 U.S. at ----, 116 S. Ct. at 2443). These findings by the Supreme Court affirmed the first Winstar

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[13] Plaintiffs in *Suess*, on the other hand, support their contrary contention. They cite to a FHLBB memorandum (dated July 15, 1985) stating clearly that "BF has indicated that without the authorization of such accounting treatment, it would be disinclined to proceed with the transaction. Accordingly, the Supervisory Agent has no objection to such accounting treatment for purposes of regulatory reporting only." Suess Pl.App. at 238. The accounting treatment referred to is set forth directly above that statement: "The value of intangible assets resulting from application of the purchase method of accounting will be amortized to expense by the straight line method over a period not to exceed 40 years." *Id.* Thus the government's argument is factually untrue as well as illogical.

decision's finding that "without a contractual guarantee of supervisory goodwill, 'no purchaser would have engaged in th[e] transaction.'" *Id.* at 4 (quoting *Winstar*, 21 Cl. Ct. at 115). The government's position can be summed up as arguing that if a deal was not insane absent a contractual commitment, then there is no contract. Seldom has a court heard such a bizarre method of determining contractual intent. When this proposition is put forth by the United States of America one is almost tempted to wonder if insanity is indeed a prerequisite for contracting with the government.

Given these findings, Defendant cannot credibly assert that the specter of insolvency was critical to the Supreme Court's holding that contracts allowing supervisory goodwill existed. "The financial condition of the resulting thrifts was only one of the circumstances noted by the Supreme Court in analyzing the 'relevant documents and circumstances' as a whole." FDIC Brief, CI # 6, at 5 (citing *Winstar*, 518 U.S. at ----, 116 S. Ct. at 2453). To assert "no immediate insolvency, therefore no contracts" ignores the wealth of other evidence that demonstrates that contracts existed. *See* Pls. Cmte. Brief, CI # 6, at 5; *see supra* note 10; *infra* citations to CalFed documents. As Plaintiffs suggest, "[a]ll acquirors were happy to accept such promises as part of the Government's *quid pro quo*--both those who needed such terms in order to protect against insolvency, and those who did not face the same extreme risks." Pls. Cmte. Brief, CI # 6, at 7. The fact that some healthy thrifts might have been healthy enough to weather a government breach of its contract obligations is relevant perhaps to the quantum of damages suffered. It is not relevant to whether a contract existed. The government takes one piece of the evidence of contractual intent found by the Supreme Court, the Federal Circuit, and this court, and turns that one piece of evidence of intent into a litmus test for when a contract exists in all cases.

This is a rendering of the courts' decisions that literally turns them on their heads.

The *CalFed* case makes the above crystal clear. Defendant asserts in *CalFed* that, with respect to the Brentwood and Family transactions, "CalFed would have remained solvent after absorbing [both failing S & Ls] even without being able to record any goodwill." Def. Resp. (CalFed) at 16. As Plaintiff Cal Fed points out, whether or not insolvency would have resulted from the acquisitions is irrelevant to the issue of whether there was a contract. CalFed Pl. Reply at 43.[14] Though in the *Glendale* case it was found to have been "irrational" to proceed with the transaction absent a contractual commitment, *see Winstar*, 518 U.S. at ----, 116 S. Ct. at 2449, "the absence of immediate insolvency without supervisory goodwill does not mean that the thrift *would* have entered into the transaction." CalFed Pl. Reply at 45 (emphasis in original). With respect to CalFed's acquisition of Family S & L, William L. Callender, Assistant General Counsel and later General

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[14] Plaintiff disputes the government's figures that purport to show CalFed's solvency after the Brentwood acquisition. "The figures the Government cites are derived from an internal Bank Board analysis that does not employ purchase accounting--and that therefore does not reduce the book value of Brentwood's loan assets to their considerably lower market value." CalFed Pl. Reply at 48. Under purchase accounting, CalFed's acquisition of Brentwood would have rendered it immediately insolvent absent supervisory goodwill. *Id.* at 48-49, 49 n. 40 ("[I]f CalFed had acquired Brentwood without recording the goodwill thereby created as capital for regulatory accounting purposes, the resulting institution would have had a negative net worth of approximately $53,118,974.") (citing James R. Wegge [Cal Fed Senior V.P.] CalFed Reply Decl. ¶ 16).

Counsel to CalFed, who personally participated in negotiating that acquisition, states that "CalFed insisted that purchase accounting could be used; that the goodwill arising from the transaction could be included in calculating capital for regulatory purposes . . . [ ]. CalFed certainly would not have acquired Family without the goodwill treatment provided under the regulatory accounting rules at the time of the acquisition." Callender Decl. ¶ 7. Plaintiff argues persuasively that the question should be whether each party would have engaged in the transaction absent the existence of a binding contract-insolvency is not the determinative factor. Both the desire to avoid huge financial loss, as well as a valid concern with the danger of insolvency, provided strong supporting evidence for the contractual nature of the promise in the Winstar cases as it does in these cases.

ISSUE No. 7

Relevant to: *Suess*, *CalFed*

> *Statement of Issue*: Fact that thrift would have been out of capital compliance on date of acquisition, but for capital contract, does not evidence existence of a capital contract, if either (1) the acquiror might have been willing to bear risk that the capital contract was illusory, or (2) the transaction also includes a government promise not to seize thrift for any failure to meet net worth requirements within five years after the date of the transaction.
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> * * *

According to the government, Benj. Franklin (the acquiring institution in Suess) "knowingly undertook risks when it proposed to purchase Equitable." Def. Cross-Mot. & Opp. (Suess) at 57. BF undertook these risks ostensibly because "[i]t had but two choices: face insolvency [itself] or purchase Equitable and hope to return to profitability." *Id.* at

58. Defendant asserts that BF's gamble did not pay off, because the thrift recorded operating losses in seven of eight years following the 1982 acquisition. *Id.* Moreover, "like the risk that it would fail to return to profitability," BF "assumed the risk that the regulatory treatment of goodwill would change in a manner unfavorable to it;" BF "also lost that gamble." *Id.* at 59. Suess Plaintiffs dispute the government's facts[15] and, justifiably, consider this spin on the law as ridiculous.

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[15] In their Supplemental Appendix A (attached to Plaintiffs' Reply brief), Suess Plaintiffs contend that "[BF] grew in size while making a profit for 16 consecutive calendar quarters from July 1, 1985 through June 30, 1989, just before the passage of FIRREA." Suess Pls. Supp.App. at 3 (citing deposition and affidavit testimony of G. Dale Weight, Chairman/CEO of BF from 1983 to 1990). Any contemporaneous reports of losses (Defendant cites to no documents, reports, or otherwise) can be explained by regulations governing financial statement reporting, rather than "economic reality." *Id.* In its Reply brief, filed July 21, 1997, Defendant continues to argue that, in 1982, BF was on the brink of insolvency. Def. Reply (Suess) at 5. According to Defendant's figures, BF reported a net loss of over $11 million on June 30, 1982, and its regulatory net worth was 3.4% of its assets. Def. Supp.App. (Suess) at 110-11. From this data, Defendant argues that "[BF]'s extremely weak financial condition made it less likely that the regulators would agree to such a promise, particularly given the moral hazard created by using goodwill as capital." Def. Reply (Suess) at 5. Plaintiffs point out, though, that "[BF's] solvency is not material or relevant to the issue of whether this was a contract . . . ." *Id.* at 4. Further, Defendant's hindsight judgment of "moral hazard" on the government's nationwide plan to relieve itself of FSLIC's insurance liability by asking healthy banks to acquire failing banks is irrelevant at best, transparently hypocritical

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First, the merger application submitted by BF and Equitable stated clearly that "the obligations of [BF] to complete the Acquisition are conditioned upon receipt of the regulatory forbearances regarding compliance with applicable net worth requirements and the other matters set forth in the form of supervisory forbearance letter . . . ." Pl.App. at 149. Having completed the acquisition of Equitable in September, 1982, BF would not have assumed that, by April, 1983 (when BF furnished the Bank Board with an independent accountant's opinion describing the treatment of goodwill and the amortization period), the regulatory treatment of goodwill was in doubt. Also, the Peat Marwick letters of June 24, 1982, August 5, 1982, and August 17, 1982 and the Kaplan-Smith "summary of revisions from initial pro-forma financial simulations" of the merger (July 21, 1982) reference the purchase accounting method and 40 year amortization of goodwill. Suess Pl.App. at 159, 167, 195, 196. Even if, as the government argues,[16] the affidavit testimony of the principal negotiators on both sides of the transaction is ignored, it is inconceivable that the government was not on notice that the 40 year amortization of goodwill was an essential part of the Equitable acquisition. James Faulstich, former President of the Seattle FHLBB, testified that the Seattle Bank "would not and could not have approved the acquisition without the long-term amortization of goodwill, because otherwise, the resulting institution would have been unsound." Pl. Reply at 6 (citing Deposition of James Faulstich, Suess Pl.App. at 65-66).

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at worst. It is much like the classic story of the person who has killed his parents and then pleads for mercy because he is an orphan!

16 *See* Def. Cross-Mot. & Opp'n (Suess).

Second, the Supreme Court observed that it would have been irrational for acquiring thrifts to stake their existence upon anything less than a contractual promise to count goodwill as regulatory capital. *Winstar*, 518 U.S. at ----, 116 S. Ct. at 2449. The fact that a hypothetical super-healthy thrift might willingly undertake the risk that the government would change the accounting rules has little to do with the real world actual transaction. BF was not such a hypothetical thrift. The government might with equal relevance suggest that a wealthy philanthropist would have been willing to make up the capital deficit.[17] Not surprisingly, "the Government has pointed to no persuasive evidence that any particular acquiror made such a choice . . . ." Pls. Cmte. Brief, CI # 7, at 2. FDIC is also correct that Defendant provides neither the factual nor legal basis "for concluding that a party's willingness to take risks justifies a court rewriting a contract to delete an agreed upon term." FDIC Brief, CI # 7, at 8.

The second part of the government's argument on this issue is simply a rehashing of Common Issue # 1. *See* Def. Supp. Resp. (CalFed) at 11 (five year net worth forbearances

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[17] Defendant contends that "[BF] was not in a position to negotiate for a guarantee with respect to future changes in regulatory policy. [BF] was desperate. At the time of the Equitable acquisition, [BF] had absolutely nothing to lose." Def. Reply [Suess] at 18. Defendant's cited support for these contentions, however, are the declarations of two individuals (Mr. Frankel & Mr. Hamm) who lack any personal knowledge of the negotiations that took place. *See* Def. Supp.App. (Suess) at 76-78. Mr. Frankel is a well-educated economics consultant with no connection to the BF-Equitable merger; Mr. Hamm was a legislative analyst reviewing California Department of Savings & Loans budgets while the BF-Equitable merger occurred.

gave the acquiring thrift sufficient incentive to make the acquisition even absent any Government promises related to goodwill); Def. Cross-Mot. & Opp'n (Suess) at 82-83 (five year net worth forbearances would have no meaning if documents were interpreted to allow BF to amortize goodwill over 40 years; the five year forbearance afforded BF the opportunity to make up almost all of any net worth deficiency). As discussed earlier, the five year net worth forbearances were separate from and complementary to any provisions for amortization of supervisory goodwill. Had such five year forbearances been sufficient to induce healthy thrifts to acquire failing ones, separate treatment of goodwill would not have been the subject of negotiation and agreement. *See* Pls. Cmte. Brief, CI # 7, at 4; *Winstar*, 518 U.S. at ---- - ----, 116 S. Ct. at 2443-44 (recognizing that the net worth forbearances issued under 12 C.F.R. § 563.13 (1981) were different from the "more complicated incentive" arising from regulators' decision "to let acquiring institutions amortize the goodwill asset over long periods, up to the forty-year maximum").[18]

Both the facts of Suess and CalFed and the law stated by the Winstar courts support Plaintiffs' argument on this common issue. Defendant's contentions rest on no evidence and hypothetical constructs which seem based on a willful ignorance of the Supreme Court's language in Winstar.

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[18] Plaintiffs note that both Statesman and Glendale "had successfully obtained Net Worth Provisions from the Bank Board. [ ]. Yet those plaintiffs were held not to have been willing to enter into the transactions in question without a binding Government promise concerning supervisory goodwill and capital compliance." Pls. Cmte. Brief, CI # 7, at 5 (citing *Winstar*, 64 F.3d at 1542.

ISSUE No. 8

Relevant to: *CalFed*, *Suess*

> *Statement of Issue*: No contract arose with respect to certain transactions either because no letter of an independent certified public accountant was submitted or because it was submitted late or was deficient, or because a plaintiff has not been able to produce a copy of the letter that was submitted, even though prior to the litigation the agencies never expressed concern over either the substance of or the absence of such a letter.
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> * * *

If this set of cases were not for such an enormous amount of money the government would never have raised this argument. It would be too embarrassed. The court finds this argument totally incredible. With respect to the Southeastern transactions in *CalFed* (where the government admits a contract existed), the government argues that Bank Board Resolution 82-72 required an independent accountant's opinion on "any intangible assets" as a precondition of the supervisory goodwill contract. Def. Resp. (CalFed) at 3. The pertinent section of Resolution 82-72 states that, if CalFed wanted to use purchase method accounting, it "shall" furnish such an opinion. CalFed avers that its independent auditors on repeated occasions did submit the required information concerning relevant supervisory goodwill, and "[f]or almost 15 years, the Government acted in a manner 180 degrees removed from any indication that the provision was not satisfied or that CalFed's use of purchase accounting was in any respect questionable." CalFed Pl. Reply at 15-16. The point is that "the better reading of the 'accountant's opinion' provision is that it imposed an independent duty on CalFed to supply such an opinion--not that the opinion was a condition of the

Government's own contractual obligation to permit purchase accounting." *Id.* at 19-20. It is quite odd to imagine that this letter was a precondition to contractual liability since this information was a part of the government's regular and continuous regulatory oversight. Further, all the evidence points to the government's complete satisfaction with the information actually obtained.

On the matter of the existence of the required accountant's letter, CalFed offers affidavits of its independent accountant and Senior VP averring that such a letter was prepared, but was destroyed in the normal course of business after 10 years. Pl. Reply at 20. Plaintiff further argues that "the Government has recently destroyed records concerning the Southeastern transaction that potentially included the letter in question." *Id.* at 21. Without the actual evidence, Plaintiff states that Fed. R. Evid. 1004 allows it to rely on secondary evidence of a lost original absent its own bad faith destruction.

Defendant's only counter to Plaintiff on this point is stated within its argument concerning contract interpretation: "[The Goodwill Forbearances] . . . simply said that CalFed could use purchase accounting if it furnished an opinion from its independent accountants to the satisfaction of the Bank Board, which it apparently never did." Def. Supp. Resp. (Cal Fed) at 12.[19] Defendant offers no evidence to support this

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[19] Defendant has provided an affidavit of a former Office of Examinations and Supervision, FHLBB official (Mr. Smuzynski), stating that the FHLBB often required independent accounting opinions during 1982 and 1983 for thrift acquisitions. "FHLBB required these opinions in order to establish an accurate accounting of goodwill as of the effective date of an acquisition." Smuzynski Decl. at 3 ¶ 8 (attached to Def. Resp. (CalFed)). Further,

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assertion, nor to refute the logic that "the Bank Board examiners who reviewed CalFed's financial condition following the Southeastern transaction would have noted the absence of the letter if it had not been sent." CalFed Pl. Reply at 21 n. 13. Finally, CalFed presents additional unrefuted evidence that the information required to be contained in the missing accountant's letter was in fact provided to the government on many occasions following the 1982 deal. *See* CalFed Pl. Reply at 22-23. "Since the purpose of the 'accountant's opinion' requirement was simply to ensure that the Bank Board had access to reliable information concerning the relevant supervisory goodwill," the various financial statements and auditor's reports provided to the government substantially complied with the requirement. *Id.* at 22-23, 25.[20]

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"amortization periods could vary according to whether the goodwill was an 'unidentifiable intangible,' such as supervisory goodwill, or an 'identifiable intangible,' such as the value of an acquired thrift's depositor base." *Id.* at ¶ 9. Plaintiff characterizes the latter statement as a "red herring; neither Resolution 82-72 nor any other aspect of CalFed's contract with the Government required CalFed to provide that information [distinguishing amortization of an acquired thrift's depositor base]." CalFed Pl. Reply at 26 n. 20. Smuzynski's affidavit does not suggest either the importance of information about an acquired thrift's depositor base, or that the information called for by the Brentwood and Family resolutions was not obtained from CalFed. Smuzynski does not recall participating in the Southeastern transactions. What this affidavit is supposed to show remains obscure.

[20] CalFed also argues persuasively that, even if the condition existed and was not substantially complied with, the government waived it as a matter of law through its course of conduct in

[Footnote continued on next page]

In *Suess*, the government raises the condition precedent argument as part of its contention that no contract existed between BF and the government concerning BF's 1985 acquisition of Western Heritage. Defendant contends that BF failed to satisfy conditions precedent to the Government's "alleged obligation" to allow BF to amortize goodwill over 40 years for regulatory purposes. The relevant document that contradicts the Government's argument is FHLBB Resolution 85-618 (Suess Pl.App. at 291-92). The key language states:

> [BF] shall submit to the Supervisory Agent an independent certified public accountant's opinion that [BF] has accounted for the Merger in accordance with [GAAP] except that for purposes of reporting to the Bank Board such principles may be modified in that . . . (b) the value of any intangible assets acquired as a result of the Merger may be amortized by the straight line method . . . .

Resolution 85-618 at 5; Suess Pl.App. at 292. This requirement is not set up as a precondition. The common sense point is (as in *CalFed*) that the "accountant's opinion" provision imposed an independent duty on Plaintiffs to

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allowing the bargained-for regulatory treatment of goodwill up through the passage of FIRREA. CalFed Pl. Reply at 27-33; Pls. Cmte. Brief, CI # 8, at 12-14 ("By sitting on its hands while institutions performed, the government waived any objection to the institutions' compliance with the accountant letter provision.") (citing *Gresham & Co. v. United States*, 200 Ct. Cl. 97, 470 F.2d 542, 554 (1972)). While this argument is quite credible, the court doesn't reach it in light of the total failure of the government's arguments and evidence on the general issue of the audit letter.

supply such an opinion--not that the opinion was a condition of the Government's own contractual obligation to permit purchase accounting. Because the accountant's opinion requirement was quite clearly not a condition of the Government's performance, Defendant's citation to FHLBB Resolution No. 85-620, to the effect that the merger was approved "subject to any conditions that may be imposed by the Bank Board in any concurrent resolution," is unavailing. *See* Def. Cross-Mot. & Opp'n (Suess) at 79 & n. 13.

Defendant also accuses Plaintiffs of failing to even mention the existence of an accountant's opinion concerning the Western Heritage acquisition in their Motion for Partial Summary Judgment. However, such an opinion is referenced as Exhibit S-9 to the FHLBB Memo of July 15, 1985, written by Mr. Faulstich sixteen days prior to the execution of the Resolutions and the Assistance Agreement. Pl.App. at 241. Neither Exhibit S-9 nor the other listed exhibits to this Memo are reproduced in Plaintiffs' Appendix. The FDIC's Brief on Common Issue # 8, at 3-4, points out that "Defendant has provided, as part of its core document production [in Suess], a memorandum from the Bank Board's outside counsel . . . stating that [BF] had complied with the conditions of the Assistance Agreement." See Suess Pl. Supp.App. at 109 (memorandum from Hopkins & Sutter stating that BF "has satisfactorily complied with the conditions set forth in § 2(b)(1)-(4) of the Assistance Agreement," which conditions included any documents required by the Agreement and "by any action of the Bank Board in approving the merger"); Suess Pl. Reply at 48. Thus, even if the government's obligations had been conditional upon an accountant's opinion, the documentary evidence available suggests that such a condition was in fact met.

As Plaintiffs suggest, there is no reason, at least in either *CalFed* or *Suess*, to find that "the absence of the accountant letter, its submission after the time specified by the FHLBB,

or its variance from the specified terminology [ ] invalidates any contract between the government and the acquiring institution . . . ." Pls. Cmte. Brief, CI # 8, at 3 (footnote omitted). The FDIC points out that "if [a] letter cannot be found, we do not see how that argument [that the opinion itself was deficient] can possibly prevail absent a contemporaneous record that the opinion was deemed deficient." FDIC Brief, CI # 8, at 5 n. 7. Defendant offered no evidence to demonstrate the deficiency of the accounting opinions submitted on behalf of either BF or CalFed. If the government had made the argument that plaintiff bank had been kidnapped by a UFO it would have been no more incredible, and a better one because at least it would be entertaining. The government's position on this issue is neither entertaining nor respectable.

ISSUE No. 9

Relevant to: CalFed, Landmark, Suess

> *Statement of Issue*: Absence of a written Assistance Agreement per se eliminates any possibility that an acquiring thrift and the government executed a capital contract, because without such an assistance agreement, the FHLBB/FSLIC resolutions, letters, and other documents and evidence cannot be given contractual effect.
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> * * *

Plaintiffs contend that this government position is unsupportable for the following general reasons: (1) "[A] high-priority objective of the Government's program to dispose of troubled thrifts was to effectuate dispositions which did not involve direct FSLIC financial assistance," and thus assisted transactions and agreements were executed only when necessary; (2) All Winstar courts based their findings that contracts existed on all of the relevant circumstances and

documents of the transaction, not because of the presence of assistance agreements; (3) The common operative fact in all *Winstar*-type transactions is that "the Government sought to induce the acquisition of a troubled thrift through promises regarding supervisory goodwill and capital compliance and was successful;" the absence of a single document is irrelevant. Pls. Cmte. Brief, CI # 9, at 2-4. The facts of these cases and the law set forth by the *Winstar* courts support Plaintiffs' position.

The first *Winstar* decision concluded that "an implied-in-fact contract existed between Winstar and the United States" without referencing the Supervisory Action Agreements [SAAs] or Assistance Agreements [AAs] involved in those transactions. *Winstar*, 21 Cl. Ct. at 114-15. This court held that "the undisputed evidence" that confirmed plaintiffs' position that contracts existed included correspondence between FHLBB and the banks and FHLBB inter-office memoranda "illustrat[ing] the reality that the promise of continued treatment of goodwill as a capital asset that could be amortized over 35 years was a negotiated and critical term of this particular transaction." 21 Cl. Ct. at 115. The Federal Circuit affirmed this conclusion and the reliance on "all of the contemporaneous documents." *Winstar*, 64 F.3d at 1541-42. The Supreme Court stated:

> [I]n other words, the SAA characterizes the Board's resolutions and letters not as statements of background rules, but as part of the "agreements and understandings" between the parties.
>
> To the extent that the integration clause [of the SAA] leaves any ambiguity, the other courts that construed the documents found that the realities of the transaction favored reading those documents as contractual commitments,

> not mere statements of policy, [ ] and we see no reason to disagree.

518 U.S. at ----, 116 S. Ct. at 2449 (citing *Restatement (Second) of Contracts* § 202(1) (1981)). The existence of an AA or SAA has not driven the courts' findings of enforceable contracts in the Winstar cases. If the factual records of individual cases show intent to contract with the government for specified treatment of goodwill, and documents such as correspondence, memoranda, and Bank Board resolutions confirm that intent, the absence of an AA or SAA should be irrelevant to the finding that a contract existed. Contracts are not technical documents requiring certain forms. Rather, they are legal relationships imposed by the law on parties when certain functional prerequisites like intent, offer, acceptance, and consideration occur in logical sequence. The contracts at issue here are no different. If the government seeks to show that in these cases, in order for a contract to occur, special requirements like an AA or SAA are mandatory it must provide some support for such a special rule. It has presented none.

CalFed concedes that there is no single, integrating SAA (as in *Winstar*) in either the Brentwood or Family transactions, but argues that this fact neither precludes reliance on *Winstar* nor rebuts the contention that a contract existed. According to the government, an "integration clause that incorporated documents relating to supervisory goodwill into the contract" was "[c]entral to the Supreme Court's determination that there was an agreement between the government and each of the thrifts." Def. Resp. (CalFed) at 14. By contrast, "[t]he resolutions and letters relied upon by CalFed are not incorporated into any agreement signed by the FSLIC," thus no "*Winstar*-like contractual obligations" were imposed on the government. *Id.* at 15. Plaintiff responds with the general observation that the integration language cited in *Winstar* was but "one basis" upon which all of the

deciding courts (from this court to the Supreme Court) found that the thrifts and the government intended to enter contracts. Equally important, according to Plaintiff, was the intent manifested from the sources other than the SAA: the agreements, negotiations, and motivations surrounding the transactions.[21] CalFed Pl. Reply at 37 (quoting *Winstar*, 518 U.S. at ----, 116 S. Ct. at 2449). Plaintiff correctly notes that integration does not create a contract but it often makes clear precisely what documents constitute the contract (and to prevent variance from the terms of those documents through parol testimony). CalFed Pl. Reply at 40-41.

Mutuality of intent, even in the context of written contracts, may be established by several contractual instruments as opposed to one superseding document. *Id.* at 38-39 (citations omitted). Contracts are frequently found to exist despite the absence of an integrating document. *Id.* at 39 n. 35. In the *Winstar* and Southeastern transaction cases, the SAAs contained language that excepted merger agreements, Bank Board letters, and resolutions from the integration document, implying that these documents stood on their own as independently enforceable agreements. *Id.* at 40 (citing *Winstar*, 64 F.3d at 1540; *Winstar*, 518 U.S. at ----, 116 S. Ct. at 2449). Based on the language cited and the conclusory nature of the government's argument, this court

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[21] Plaintiff also argues that, if no express contract is found, an implied-in-fact contract existed based on conduct that indicated assent (intent, offer, acceptance, and consideration) to the proposed bargain. CalFed Pl. Reply at 42 (citing *Winstar*, 64 F.3d at 1542 (inference of a contract from the documents is supported by the circumstances surrounding the transaction)). The court need not reach this argument since there was an express contract in this case.

must conclude that contracts existed between CalFed and the government as to the Brentwood and Family transactions.[22]

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[22] The documentary evidence for both the Brentwood and Family transactions demonstrates that purchase accounting and amortization of goodwill were essential terms of the negotiated transactions. In the Brentwood deal, CalFed specifically requested approval from the FHLBB to amortize goodwill created by the acquisition "under the purchase method of accounting using the straight line method over the estimated useful life of 35 years . . . ." CalFed Mot. Summ. J. at 10-11 (citing a September 2, 1982 Letter from Cal Fed to FHLBB). The Bank Board approved the acquisition on September 30, 1982, and on October 1, 1982, issued a forbearance letter stipulating that "[t]he resulting association may amortize any goodwill created under the purchase method of accounting using the straight line method over [ ] 35 years . . . ." *Id.* at 12 (Ex. 11 to Wegge Decl. CalFed Mot. Summ. J.). The Family acquisition proceeded similarly, though the commitment regarding amortization of goodwill was contained in the Acquisition Agreement, Article 6.1(a): "The Resulting Association may amortize any goodwill created under the purchase method of accounting using the straight line method over the useful life of 40 years . . . ." *Id.* at 16 (Ex. 18 to Wegge Decl.). This amortization was structured in the Agreement as a condition precedent to CalFed's obligations. *Id.* The merger application sent to the Bank Board included the Acquisition Agreement and an additional request to approve the 40 year amortization. *Id.* at 17. In two subsequent letters dated November 26, 1982 and January 5, 1983 (forbearance letter), the Bank Board confirmed CalFed's entitlement to "record the merger under the purchase method of accounting" and amortize resulting goodwill over 40 years. *Id.* at 17-18. There is no factual dispute concerning these documents, and these documents are exactly the type of evidence relied upon

[Footnote continued on next page]

In *Landmark*, Defendant raises the instant argument as part of its attempt to show that no contract existed between it and Landmark with respect to Landmark's acquisition of St. Bernard S & L and the supervisory forbearances issued in connection therewith. Def. Cross-Mot. & Opp'n (Landmark) at 18-20. However, the *Landmark* record again belies Defendant's claims that Winstar should not apply.

In July, 1986, the Bank Board "suggested that Landmark again [it had acquired Dixie in 1982] acquire savings and loan associations that had negative net worth." Landmark Pl. Mot. Summ. J. at 7. Accordingly, "[t]he agreement between the Bank Board and Landmark was that St. Bernard Savings would be converted to a stock association and acquired by Dixie Savings, and that Dixie Savings would contribute all its real estate and all of the stock in its service corporation Landmark Land Development Co., Inc., to St. Bernard Savings using purchase accounting . . . ." *Id.* Resolution 86-693 was issued "to embody the terms of the agreement." *Id.* at 8; see FHLBB Resolution 86-693 at 5 ("Severe financial conditions exist which threaten the stability of St. Bernard, the accounts of which are insured by FSLIC;" "[t]he proposed acquisition would lessen the risk to FSLIC"); March 11, 1986 Letter from Dallas FHLBB to Washington D.C. Office of Examinations and Supervision ("St. Bernard is a severe supervisory case and its condition is continuing to deteriorate [;] we believe it is necessary to move on [Landmark-Dixie's] proposal as quickly as possible"). "The transaction with St. Bernard Savings was accounted for by 'purchase accounting' which was authorized 'for all purposes' by the Assistance Agreement dated September 30,

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[Footnote continued from previous page]
by the *Winstar* courts to establish the existence of thrifts' contracts with the government.

1982." *Id.* at 9.[23] Another resolution, FHLBB Resolution 86-801, specifically requires that Landmark furnish an independent accountant's opinion that "describes the entries recording the push-down [purchase] accounting on the books of St. Bernard and [ ] substantiates the reasonableness of the anticipated amortization methods and periods for the intangible assets, discounts, and premiums." Resolution No. 86-801 at 2. In a July 16, 1986 letter to Landmark's president (Barton) from FHLBB, the Bank Board stated:

> For the purposes of reporting to the Bank Board, with respect to the books and records of St. Bernard, push-down accounting shall be used to record the purchase of St. Bernard's capital stock, in accordance with generally accepted accounting principles and Office of

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[23] It is clear that the FSLIC needed a healthy institution to bail out St. Bernard. Landmark asserts that the negotiated 1986 transaction "was intended to provide a permanent solution to the severe financial condition of St. Bernard through which Landmark's or Dixie's real estate assets would be valued at fair market value as of the date of the St. Bernard acquisition on a permanent basis." Landmark Pl. Reply at 29 (citing Affidavit of Gerald Barton (1997) ¶¶ 41-43) ("The 1986 capital contribution to St. Bernard by Landmark and its subsidiaries included real estate or subsidiaries with a fair market value of approximately $713,000,000 as determined by written appraisal reports which were accepted by the FHLBB."); *see* FHLBB Internal Memo of August 4, 1986, at 3 ("appraisals were ultimately found to contain sufficient data to sustain the values . . . [a] minor part of the total property to be contributed to this deal has a fair market value of about $32.25 million--far in excess of that required for St. Bernard to qualify as a viable institution") [Landmark Pl. Reply Ex. 12].

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Landmark Pl. Reply Ex. 16, at 2. Defendant thus agreed to be bound to exercise such forbearance.[24] The requisite intent existed to form a contract.

Second, the Landmark documents show undisputedly that offer and acceptance were present in this transaction. A May 15, 1986 letter from Landmark counsel to FHLBB is evidence that an "Application for Voluntary Supervisory Conversion of St. Bernard Federal Savings & Loan Association" was delivered by hand to FHLBB offices in Washington, D.C. on that date. Landmark Pl. Reply Ex. 15. The previously referenced Resolutions, the July 16, 1986 Letter, and the Internal Memo of August 4, 1986 (noting approval of the Applications on 7/14/86) all demonstrate that Landmark's offer was accepted. *See* FDIC-Intervenor Brief at 22-23 (explaining the distinction between pure regulatory conduct and commercial, non-regulatory conduct by government agencies; "[i]n the St. Bernard transaction . . . the resulting forbearance contract was in fact a necessary condition in order to relieve the FSLIC insurance find from having to make a payout.").

Third, consideration was exchanged. Landmark received the supervisory forbearances set forth in the Resolutions and the July 16, 1986 Letter. In summary, "supervisory goodwill created as a result of the recapitalization of St. Bernard could be counted in

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24 "FHLBB also agreed in the July 16, 1986 forbearance letter to exclude the property contributed by [Plaintiff] from any regulatory limitations on direct investments in subsidiaries for a period of five years and to continue the waiver for those assets for as long as they were held." FDIC-Intervenor Brief at 12.

determining compliance with its minimum regulatory capital requirement." FDIC-Intervenor Brief at 12.[25] The government was given the benefit of being relieved of the obligation to liquidate a failing bank. *See* FHLBB Resolution 86-693, at 5 ("St. Bernard is a failing institution"). There is thus ample record evidence that a contract existed between Plaintiff and the government concerning the supervisory forbearances expressed in the St. Bernard documents, despite the absence of an AA or SAA.

Finally, in *Suess*, the government asserts that "[t]he existence of these express, written contracts executed by both the FSLIC and the acquiring thrifts was the Federal Circuit's basis for concluding that the parties had intended to form a contract." Def. Cross-Mot. & Opp'n (Suess) at 22 (citing *Winstar*, 64 F.3d at 1537-38). This is without merit The Federal Circuit specifically stated that, in each of the three transactions at issue (*Glendale*, *Statesman*, and *Winstar*), Supervisory Action Agreements and/or Assistance Agreements were not *sine qua non* to the existence of contracts, but merely "part" of the transactions. 64 F.3d at 1537-38, 1540; ("Glendale's contract not limited to the SAA itself, but also included the contemporaneous resolutions and

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[25] The 1986 transaction, unlike the 1982 transaction, was unassisted, meaning that FSLIC made no capital contributions to the acquiring entity. "Rather than FSLIC assistance for the resolution of St. Bernard, Oak Tree and the FHLBB agreed that supervisory goodwill would be created and real estate assets that had been contributed to the Dixie subsidiary during 1983 would be marked to their fair value at the date of the St. Bernard acquisition. In addition, Dixie received the right to hold these real estate assets without regard to otherwise applicable regulatory restrictions." FDIC-Intervenor Brief at 19 (citing July 16, 1986 forbearance letter).

letters issued by the FSLIC and the Bank Board"). Further, the court concluded, "based on all of the contemporaneous documents," and "supported by other evidence and by the circumstances surrounding the transaction," that mutual intent to contract existed, and that a contract concerning the use of supervisory goodwill for regulatory capital purposes was formed. *Id.* at 1541-42. The government also relies on language from *Charter Federal Sav. Bank v. Office of Thrift Supervision*, 976 F.2d 203 (4th Cir. 1992), to establish that an FHLBB resolution cannot constitute a contract, but merely operates as approval of a merger agreement between two private parties. Def. Cross-Mot. & Opp'n (Suess) at 22-23. As Plaintiffs point out, this reasoning "has [ ] been explicitly rejected by this Court, the Federal Circuit, and the Supreme Court." Suess Pl. Reply at 14 & n. 7.[26]

The relevant transaction (to this Common Issue) in *Suess*, BF's acquisition of Equitable, is less explicitly documented than those in either *CalFed* or *Landmark*. However, *Suess* Plaintiffs adequately demonstrate that the intent existed to form a contract concerning the amortization of goodwill. Suess Pl. Mot. Summ. J. at 8-12 (citing letters, the Merger Application, independent accountants' opinions, the FHLBB-Seattle's internal "merger digest," and deposition and affidavit testimony of government and BF negotiators).

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[26] Impervious to the clear language of the Winstar decisions, Defendant's Reply brief in Suess again articulates the argument that because there was no assistance agreement executed in connection with the BF-Equitable merger, there was no *Winstar*-type contract between BF and the government. Def. Reply (Suess) at 17.

In sum, the facts of these three cases and the law that controls them all mandate that Defendant's contentions on Common Issue # 9 be rejected.

ISSUE No. 10

Relevant to: Suess

> *Statement of Issue*: Where a capital contract was made between a thrift acquiror and a FHLBB Principal Supervisory Agent ("PSA") located at a regional Federal Home Loan Bank rather than with a Bank Board official geographically located at the Federal Home Loan Bank Board in Washington, no contract can exist per se because no Principal Supervisory Agent had authority to make such a contract with a thrift acquiror.
>
> * * *

Defendant argues that the regional Bank Board officials, the PSAs, lacked authority "to bind the Government to assume, for [the relevant amortization period], the risk of future changes in Federal laws and regulations." Def. Cross-Mot. & Opp'n (Suess) at 59. Defendant thus questions "only the authority of the [PSAs] to approve mergers that contain a goodwill term." FDIC Brief, CI # 10, at 2.

Defendant's claim is difficult to understand, given that "the Bank Board expressly delegated to its [PSAs] in the field the authority to approve unassisted mergers in which goodwill was included in net assets and regulatory capital." FDIC Brief, CI # 10, at 3 (citing 47 Fed. Reg. 8152, 8153

1(982) [effective Feb. 23, 1982]);[27] *see* Pls. Cmte. Brief, CI # 10, at 8- 9. In addition, the Supreme Court's decision addressed the issue of delegated authority, and resolved it in favor of plaintiff thrifts.

First, the Court stated that the cases before it did not involve "contracts to surrender the Government's sovereign power to regulate." *Winstar*, 518 U.S. at ----, 116 S. Ct. at 2462. Similarly, *Suess* Plaintiffs are not asserting that the Seattle Bank's PSA (Mr. Faulstich) purported to bind the Federal government not to regulate away the agreed upon treatment of goodwill. Further, after reviewing the statutory grounds for the Bank Board's "specific powers in the context of supervisory mergers," the Court concluded that "[t]here is no serious question that FSLIC (and the Bank Board acting through it) was authorized to make the contracts in issue." 518 U.S. at ---- - ----, 116 S. Ct. at 2462-63. The regulations in effect between 1982 and FIRREA's enactment and the Winstar decision itself confirm that "the ability to bind the government to compensate the acquiring thrifts in the event of a change in the accounting treatment of supervisory goodwill was indisputably necessary to effectuate [the relevant] mergers [;] the power to approve mergers in which supervisory goodwill was included in assets for regulatory net worth purposes would have been all but meaningless without the power to contract . . . ." Pls. Cmte. Brief, CI #

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[27] In 1983, the Bank Board gave PSAs authority to approve "certain assisted mergers and to authorize the expenditure of FSLIC funds." Pls. Cmte. Brief, CI # 10, at 10 n. 14 (citing 48 Fed. Reg. 27394 (1983)).

10, at 13. Even without any illuminating arguments from Plaintiffs,[28] Defendant's basic claim is doomed to failure.

Defendant's particular argument on this issue in Suess can be disposed of quickly. Defendant argues that Mr. Faulstich, the president of the regional (Seattle) Bank Board, "lacked authority to enter into a binding agreement with Franklin respecting the future regulatory treatment of the Equitable goodwill." Def. Cross-Mot. & Opp'n (Suess) at 61.[29] Faulstich "neither sought, nor received, a legal opinion that he had authority to guarantee Franklin against changes in the regulatory treatment of goodwill . . . ." *Id.* at 62. Of course, no federal employee has such authority. The question is whether he had the authority to enter into a contract, and whether he did in fact do so with respect to

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[28] Plaintiffs do argue persuasively that, either by express grant of authority (the regulations), implied actual authority (based on the integral duties of PSAs and the national policies of the Bank Board and FSLIC, recognized by the Winstar courts), or ratification (given the FHLBB's necessary approval and/or constructive knowledge of the transactions), the actions of PSAs resulted in legally binding contracts. Pls. Cmte. Brief, CI # 10, at 6-10, 11-14, and 15-17, respectively.

[29] In its Reply brief, Defendant presses its point: "Authority to approve a merger pursuant to existing regulations does not, however, constitute authority to enter into contracts binding the Government's future regulatory [sic] for 40 years." Def. Reply (Suess) at 23. Continuous recycling of an argument that is directly at odds with the regulations in place at the relevant times and the statement of the Supreme Court that there is no question that the Bank Board possessed authority to enter the type of contract at issue in Suess (admittedly, minus an AA or SAA) does not improve the strength or quality of the government's arguments.

BF's merger with Equitable. *See* 64 F.3d at 1548 ("[T]he Bank Board and the FSLIC, as the principal regulators of the thrift industry, were fully empowered to enter into the contracts at issue here."). This issue is settled in favor of Plaintiffs' position. *See* FDIC Supp. Brief, CI # 10, at 3-4 ("Specifically, the Bank Board gave 'delegated authority to allow the Principal Supervisory Agent to approve merger applications in which goodwill is included in assets.'") (quoting 47 Fed. Reg. 8152 1(982)); Def.App. (Suess) at 133 (Faulstich's September 8, 1982 letter approving the merger is stamped "BOARD ACTION UNDER DELEGATED AUTHORITY").

ISSUE No. 12

Relevant to: Suess

> *Statement of Issue*: "Successor regulation" language in an assistance agreement, net worth maintenance agreement, or in other agreements per se placed the risk of change in the law on the acquiring thrift.
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> * * *

This argument is a formalized version of the government's *Winstar* contention that the commitments regarding goodwill amortization contained in the agreements between the acquiring thrifts and the government merely reflected then-current statements of regulatory policy. The *Winstar* Court found this contention meritless. Defendant clearly lost this argument; Justice Scalia's concurrence labels it as a losing argument and explains why: "If, as the dissent believes, the Government committed only 'to provide [certain] treatment unless and until there is subsequent action' . . . then the Government in effect said 'we promise to regulate in this fashion for as long as we choose to regulate in this fashion'--which is an absolutely classic description of an

illusory promise." *Winstar*, 518 U.S. at ----, 116 S. Ct. at 2477 (Scalia, J., concurring).

Winstar's Assistance Agreement provided for amortization of goodwill over 35 years, and stated that "the governing regulations and the accounting principles shall be those in effect on the Effective Date or as subsequently clarified, interpreted, or amended by the Bank Board or the Financial Accounting Standards Board ("FASB"), respectively, or any successor organization to either." *Winstar*, 518 U.S. at ----, 116 S. Ct. at 2450. The government argued that this language "barr[ed] any inference that the Government assumed the risk of regulatory change." *Id.* The Court found that this argument "ignore[d] the preceding sentence providing that the Bank Board's resolutions and actions in connection with the merger must prevail over contrary regulations." *Id.* With respect to Statesman, the Court construed similar language which required Statesman to comply with "all applicable statutes, regulations, orders of, and restrictions imposed by the United States" to mean only "that Statesman was required to observe FIRREA's new capital requirements once they were promulgated." *Id.* at ----, 116 S. Ct. at 2451. The Court went on to state that such language was "hardly necessary to oblige Statesman to obey the law, and nothing in [that language] barred Statesman from asserting that passage of that law required the Government to take action itself or be in breach of its contract." *Id.* The Court then emphasized that "[n]othing in the documentation or the circumstances of these transactions purported to bar the Government from changing the way in which it regulated the thrift industry." *Id.* at ----, 116 S. Ct. at 2452.

As part of its argument that there was no contract between BF and the government with respect to the Western Heritage transaction, Defendant asserts that FHLBB

Resolution 85-618 allocated the risk of regulatory change to BF. In particular, Defendant points to the following language:

> RESOLVED FURTHER, That in accounting for the Merger, Benj. Franklin shall use generally accepted accounting principles prevailing in the savings and loan industry, as accepted, modified, or clarified by applicable regulations of the Bank Board and the FSLIC.

Res. 85-618, at 4; Suess Pl.App. at 291. According to Defendant, because this provision contemplated "that the governing legal and accounting principles were subject to change," the change occasioned by FIRREA did not breach any promises.

The Western Heritage Assistance Agreement contains language identical to the language the Supreme Court interpreted in *Winstar* with respect to the Winstar transaction. *See* Suess Pl.App. at 279; Western Heritage AA § 10.[30] However, this section does not specify the goodwill amortization period, as the corresponding Winstar AA did.

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[30] Section 10 states: Accounting Principles: Except as otherwise provided, any computations made for purposes of this Agreement shall be governed by generally accepted accounting principles as applied in the savings and loan industry, except that where such principles conflict with the terms of the Agreement, applicable regulations of the Bank Board or [FSLIC], or any resolution or action of the Bank Board approving or relating to the Merger or to this Agreement, then this Agreement, such regulations, or such resolution or action shall govern. [ ]. If there is conflict between such regulations and the Bank Board's resolution or action relating to the Merger or to this Agreement, the Bank Board's resolution or action shall govern. Suess Pl.App. at 279.

See supra. BF's goodwill from the Western Heritage acquisition is governed by Resolution 85-618, which states in relevant part:

> [T]he cash contribution by the FSLIC to Benj. Franklin with respect to Western Heritage pursuant to the Assistance Agreement shall be deemed a contribution to net worth; [ ] the value of any intangible assets acquired as a result of the Merger may be amortized by Benj. Franklin over a period of forty (40) years by the straight line method.

Suess Pl.App. at 292; Res. 85-618 at 5. By letter of August 12, 1985, the Bank Board confirmed this treatment of goodwill and the forty year amortization period, using identical language. Suess Pl.App. at 297-98. Section 16 of the Assistance Agreement contained an integration clause that clarifies that the AA's provisions do not supersede Bank Board resolutions or letters issued in connection with the transaction; accordingly, the resolutions and letters are part of the contract. Suess Pl.App. at 283; *Winstar*, 518 U.S. at ---- - ----, 116 S. Ct. at 2471-72 (affirming that Bank Board resolutions and letters were part of the contractual undertakings by the government with respect to supervisory goodwill). Given the language of the Western Heritage Assistance Agreement, Resolution 85-618, and the August 12, 1985 letter, there is no way to distinguish BF's case from Winstar's. The court is required to follow the Supreme Court and reject Defendant's argument that "successor regulation" language shifted the risk from the government to BF. *See Winstar*, 518 U.S. at ----, 116 S. Ct. at 2449 (holding that the government's interpretation of the Glendale documents as reflecting then-current regulatory policy rather than contractual undertakings was

"fundamentally implausible"); Pls. Cmte. Brief, CI # 12, at 15-18; FDIC Brief, CI # 12, at 4-6.[31]

CONCLUSION

Defendant's arguments on the eleven Common Issues Nos. 1-10 and 12 range from the rejected to the implausible. This is especially so since the arguments are heavily legal, and the government persists in ignoring or misrepresenting the law while failing to distinguish the cases factually.

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[31] Plaintiffs and FDIC discuss two other versions of this argument in their briefs: (1) language suggesting that the regulations setting forth the level of capital required may change "effectively shifted to the acquiror the risk of a change in the law with respect to the government's promise to count certain intangible assets as capital;" (2) "language with regard to regulations setting the level of capital that a thrift must maintain 'allocated any risk of regulatory change to' the plaintiffs with respect to the government's agreement to count various intangible assets as part of the thrift's regulatory capital." Pls. Cmte. Brief, CI # 12, at 5-6 (citing various government briefs). Defendant's arguments on both points are unsupportable, absent specific factual showings that agreements in individual cases differed significantly from the language construed in Winstar. *See Winstar*, 64 F.3d at 1544 ("This stipulation by Winstar to maintain its regulatory net worth at whatever level the regulators set does not, however, eclipse the government's own promise that *Winstar* could count supervisory goodwill in meeting the regulatory requirements with which it had promised to comply."); Pls. Cmte. Brief, CI # 12, at 13-14 ("[A] general provision setting forth the parties obligation to obey the law--which is implied in any event, whether express or not--does not authorize the government to abrogate its contractual commitments without liability by changing the law.") (citing *Lynch v. United States*, 292 U.S. 571 (1934)).

Summary judgment on these Common Issues is thus appropriately granted to Plaintiffs.

THE COURT THUS ORDERS THE FOLLOWING:

In all *Winstar*-related cases where there are pending summary judgment motions or cross-motions filed by the plaintiffs, the United States shall show cause, within 60 days, why those motions should not be granted, and liability found on all *Winstar* contract issues based upon the instant decision. In all cases where the government has a pending summary judgment motion or cross-motion the government shall show cause within 60 days, why those motions should not be denied, for the same reasons.

Following the submission of any summary judgment motion on liability in any Winstar-related case the United States shall have 90 days to show cause why that motion should not be granted on the same basis.

The government in responding to this order shall not raise issues that have been resolved by opinions in the original Winstar cases as clarified in this decision. Irrespective of ultimate attorneys fee issues in these cases, failure to follow this order will require the government to reimburse the plaintiffs for attorneys fees spent litigating issues that have already been resolved by this court, the Federal Circuit or the Supreme Court.

IT IS SO ORDERED.

APPENDIX F

In the United States Court of Appeals
for the Federal Circuit

* * * * * * * * * * * * * * *

CALIFORNIA FEDERAL BANK, *
*
Plaintiff-Appellant, *
v. 03-5070, -5082
*
UNITED STATES, *
Defendant-Cross Appellant. *

* * * * * * * * * * * * * * *

Mark A. Perry, Gibson, Dunn & Crutcher LLP, of Washington, DC, argued for plaintiff-appellant. With him on the brief were John C. Millian, Theodore J. Boutrous, Jr., Paul Blankenstein, and Andrew S. Tulumello. Of counsel was Thomas G. Hungar.

Lee M. Straus, Trial Attorney, Commercial Litigation Branch Civil Division, United States Department of Justice, of Washington, DC, argued for defendant-cross-appellant. With him on the brief were Stuart E. Schiffer, Deputy Assistant Attorney General; David M. Cohen, Director; Jeanne E. Davidson, Deputy Director; and Tarek Sawi, Trial Attorney.

Appealed from: United States Court of Federal Claims

Judge Roger H. Hodges, Jr.

United States Court of Appeals for the Federal Circuit

03-5070, -5082

CALIFORNIA FEDERAL BANK,

Plaintiff-Appellant,

v.

UNITED STATES,

Defendant-Cross Appellant.

DECIDED: January 19, 2005

Before MAYER,* BRYSON, and LINN, Circuit Judges.

BRYSON, Circuit Judge

This case, like others that have reached this court in the wake of the Supreme Court's decision in *United States v. Winstar*, 518 U.S. 839 (1996), involves a claim of breach of contract based on the enactment of the Financial Institutions Reform, Recovery, and Enforcement Act ("FIRREA"), Pub. L. No. 101-73, 103 Stat. 183 (1989). In the 1980s, in the midst of the savings and loan crisis, the Federal Savings and Loan Insurance Corporation ("FSLIC") arranged for various healthy financial institutions to acquire failing savings and loan associations (or "thrifts"). FSLIC settled on the acquisition strategy to minimize the number of outright failures among savings and loan associations and the consequent financial burden on FSLIC, as insurer of the

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* Haldane Robert Mayer vacated the position of Chief Judge on December 24, 2004.

deposits of many of those thrifts. Because the failing thrifts were unattractive investment prospects on their own, FSLIC had to offer substantial incentives to the acquiring institutions to induce them to acquire the failing thrifts and take on their liabilities. The inducements frequently consisted of promises regarding the manner in which the acquiring institutions would be permitted to treat the acquired thrifts' assets and liabilities for accounting purposes. In many instances, FSLIC promised the acquiring institutions that they would be allowed to include the acquired thrifts' net liabilities as "supervisory goodwill" in their calculation of regulatory capital and to amortize the supervisory goodwill over a lengthy period of time.

In 1981 and 1982, appellant California Federal Bank ("CalFed") acquired the assets and assumed the liabilities of six failing thrifts in acquisitions supervised or approved by FSLIC or its parent, the Federal Home Loan Bank Board ("the FHLBB"). As part of the acquisition transactions, FSLIC and the FHLBB promised CalFed that it could include more than $600 million in "supervisory goodwill" in calculating its regulatory capital and that it could amortize that supervisory goodwill over an extended period. After the enactment of FIRREA in 1989 and the promulgation of conforming regulations, however, acquiring institutions such as CalFed were no longer permitted to include supervisory goodwill as part of their regulatory capital, and they were required to write down their supervisory goodwill over a five-year period.

Based on the new restrictions on the use and amortization of supervisory goodwill, many acquiring institutions sued the government in the Court of Federal Claims contending that the new requirements resulted in a breach of the acquisition contracts. In the *Winstar* case, the Supreme Court held that the breach of the promises regarding the maintenance of regulatory capital and the depreciation of

supervisory goodwill could constitute a breach of contract by the government for which acquiring institutions could recover damages.

CalFed was one of the institutions that filed a breach of contract action based on the FIRREA provisions regarding supervisory goodwill. The trial court granted summary judgment for CalFed on the issue of liability. *Cal. Fed. Bank v. United States*, 39 Fed. Cl. 753 (1997). CalFed then sought to recover damages on several theories, including a "lost profits" theory. With regard to that theory, CalFed contended that the statutory and regulatory changes associated with the enactment of FIRREA forced it to sell certain assets, including a large number of adjustable rate mortgages ("ARMs") in order to meet the new regulatory capital requirements. Those ARMs, according to CalFed, would have produced substantial profits if CalFed had been able to retain them. The trial court, however, granted summary judgment for the government on that theory of recovery. *Cal. Fed. Bank v. United States*, 43 Fed. Cl. 445 (1999). After a trial on the remaining claims, the court denied reliance damages and restitution, but it awarded CalFed $23 million to compensate CalFed for the cost of replacing the regulatory capital lost because of the accelerated phase-out of supervisory goodwill under FIRREA.

Both parties appealed to this court. We affirmed the grant of summary judgment on the issue of liability, but reversed the grant of summary judgment on CalFed's lost profits theory, holding that there were genuine issues of material fact with respect to foreseeability, causation, and the measurement of damages. *Cal. Fed. Bank, FSB v. United States*, 245 F.3d 1342 (Fed. Cir. 2001). Accordingly, we remanded for trial on damages based on CalFed's lost profits theory.

Following a six-week trial, the Court of Federal Claims declined to award CalFed lost profits damages. *Cal. Fed. Bank v. United States*, 54 Fed. Cl. 704 (2002). The court based its ruling on three general findings: (1) that CalFed had failed to prove its loss of profits from the sale of the assets, including the ARMs, was foreseeable; (2) that CalFed had failed to prove that the ARMs and other assets were sold because of the breach; and (3) that the method of calculating damages advocated by CalFed was too speculative to serve as the basis for a damages award.

CalFed has appealed from the trial court's denial of damages on a lost profits theory. The government has cross-appealed with respect to the issue of liability, contending that FSLIC did not have the authority to bind the United States contractually with respect to the acquisition transactions.

I

A

Contract remedies are designed to make the nonbreaching party whole. One way to achieve that end is to give the nonbreaching party "expectancy damages," i.e., the benefits the nonbreaching party expected to receive in the absence of a breach. *Glendale Fed. Bank, FSB v. United States*, 239 F.3d 1374, 1379 (Fed. Cir. 2001), citing *Restatement (Second) of Contracts* § 344(a) (1981). In order to be entitled to expectancy damages, which include lost profits, the plaintiff must satisfy three requirements. First, the plaintiff must show that the lost profits were within the contemplation of the parties because the loss was foreseeable or because the defaulting party had knowledge of special circumstances at the time of contracting. *La Van v. United States*, 382 F.3d 1340, 1351 (Fed. Cir. 2004); *Energy Capital Corp. v. United States*, 302 F.3d 1314, 1325 (Fed. Cir. 2002), citing *Restatement (Second) of Contracts* § 351(1) (1981). Second, the plaintiff must establish that there would have been a profit but for the breach. *Rumsfeld v. Applied Cos.*,

325 F.3d 1328, 1339 (Fed. Cir. 2003). Third, the measure of damages must be reasonably certain, although if "a reasonable probability of damage can be clearly established, uncertainty as to the amount will not preclude recovery." *Glendale Fed. Bank, FSB v. United States*, 378 F.3d 1308, 1313 (Fed. Cir. 2004), quoting *Locke v. United States*, 283 F.2d 521, 524 (Ct. Cl. 1960).

For the reasons set forth below, we uphold the trial court's judgment based on its ruling on the issue of causation. Because that issue is dispositive of CalFed's appeal, we need not address the issues of foreseeability and the measurement of damages on which the trial court also ruled against CalFed.

B

CalFed first argues that the trial court used the wrong standard in determining whether CalFed proved that the government's breach caused the bank to sell the ARMs. The court relied on *Myerle v. United States*, 33 Ct. Cl. 1, 27 (1897), for the standard of causation that lost profits must "inevitably and naturally, not possibly nor even probably" flow from the defendant's breach. Citing *Bluebonnet Savings Bank, F.S.B. v. United States*, 266 F.3d 1348 (Fed. Cir. 2001), CalFed argues for a less exacting standard; it contends that the breach need only be a "substantial factor" contributing to the loss. The Court of Federal Claims stated that it would reach the same conclusion regardless of which of the two standards is applied.

The passage from the *Bluebonnet* case on which CalFed relies does not state or imply that the causation requirement is satisfied any time the breach is a "substantial factor" in causing the claimed lost profits. The court in *Bluebonnet* noted that the trial court had found that the breach "was a substantial factor in *Bluebonnet*'s increased financing costs," 266 F.3d at 1356, reflecting the way the trial court characterized its finding. *See Bluebonnet Sav. Bank, FSB v.*

United States, 47 Fed. Cl. 156, 173, 180 (2000). Importantly, however, the court upheld the trial court's ruling on causation only after concluding that "[t]he government's various arguments regarding alternative causes for the damages lack merit." 266 F.3d at 1356. That statement is consistent with the standard applied by this court and our predecessor court in numerous cases, including the previous appeal in this case, that the causal connection between the breach and the loss of profits must be "definitely established." *La Van v. United States*, 382 F.3d at 1351; *Hi-Shear Tech. Corp. v. United States*, 356 F.3d 1372, 1379 n.2 (Fed. Cir. 2004); *Energy Capital Corp. v. United States*, 302 F.3d 1314, 1325 (Fed. Cir. 2002); *Cal. Fed. Bank, FSB v. United States*, 245 F.3d 1342, 1349 (Fed. Cir. 2001); *Neely v. United States*, 285 F.2d 438, 443 (Ct. Cl. 1961). The standard set forth in those cases ensures that the nonbreaching party will not be awarded more than it would have received if the contract had been performed. *Applied Cos.*, 325 F.3d at 1340. Thus, the Court of Federal Claims correctly rejected the "substantial factor" test advocated by CalFed.

That is not to say that the breach must be the sole factor or sole cause in the loss of profits. The existence of other factors operating in confluence with the breach will not necessarily preclude recovery based on the breach. *See, e.g.*, E. Allan Farnsworth, *Contracts* § 12.1, at 150-51 (3d ed. 2004). However, lost profits are "a measurement of what a party would have received absent the breaching party's action," *Cienega Gardens v. United States*, 331 F.3d 1319, 1341 (Fed. Cir. 2003), *i.e.*, those losses that would not have occurred but for the breach, *see San Carlos Irriqation & Drainage Dist. v. United States*, 111 F.3d 1557, 1563 (Fed. Cir. 1997). The inability to prove by a preponderance of the evidence that profits would have been made but for the breach will therefore preclude recovery on a lost profits theory.

C

At trial, CalFed based its lost profits case on three theories of loss: (1) that the government's breach forced it to shrink the size of the bank by selling nearly 25,000 ARMs, which would have proved highly profitable if CalFed had retained them; (2) that the breach forced CalFed to sell California Thrift & Loan ("CTL"), an automobile financing company, which also would have proved profitable if CalFed had retained it; and (3) that the breach forced CalFed to forgo making various other highly profitable loans that it would have made if it had not had to satisfy the more exacting capital requirements following the enactment of FIRREA. In its opinion entered following the trial, the trial court rejected each of those theories on factual grounds.

With respect to the ARMs, the trial court rejected CalFed's assertion that the breach caused it to dispose of the 24,664 ARMs that it claimed to have sold in order to meet the more exacting capital requirements imposed following FIRREA's enactment. The court concluded that it was the recession in the California real estate market in the early 1990s that "caused CalFed to shrink the bank," not the changes in regulatory requirements that resulted from the enactment of FIRREA. As to CalFed's argument that FIRREA precipitated a massive sell-off of ARMs, the court noted that CalFed had sold a roughly similar number of ARMs prior to the breach and that the bank's "business was selling loans, before and after the breach." Contrary to CalFed's contention, the court found that the evidence at trial showed that originating mortgage loans and selling them into the secondary market was an integral part of CalFed's operations and that its business plan of originating and selling mortgage loans did not change after the breach.

Based on the evidence at trial, the court found that CalFed "likely would have sold most of its adjustable rate mortgages irrespective of the breach." The court noted that

at the time CalFed was selling the ARMs, it was investing in higher risk loans, which required higher capital ratios. From that evidence, the court concluded that CalFed chose to sell the ARMs, rather than cease acquiring high-risk assets, because it preferred to continue high-risk lending. The court also noted that the evidence showed that CalFed had good reasons to sell the ARMs: the sale satisfied management's desire to generate a higher ratio of tangible net worth to tangible assets, and the bank recorded capital gains of $28 million on the sales, which it used to offset losses. Based on all the evidence, the court concluded that CalFed could have remained in capital compliance without selling the ARMs in the aftermath of the breach and that the bank "likely would have sold many or most of its adjustable rate mortgages had the breach not occurred."

With respect to the sale of CTL, the trial court similarly rejected CalFed's argument that the breach forced it to sell. Instead, the court found that CalFed sold CTL because "it did not fit into [CalFed's Chief Executive Officer Jerry St. Dennis's] 'back-tobasics' plan for the company." The court explained that Mr. St. Dennis "wanted to return the bank to traditional lending strategies that had made it successful. He did not view the automobile finance company as such a business." Moreover, the court found that at the time CalFed sold CTL, CalFed's capital obligations had already been satisfied, so it was not necessary for CalFed to sell CTL. Based on the evidence, the court concluded that Mr. St. Dennis "wanted to sell the automobile financing business .... [CalFed] was not forced to sell CTL because of the breach."

With regard to the other forgone assets, CalFed claimed that it suffered damages because the capital maintenance requirements forced it to forgo making other highly profitable loans and that it is entitled, as damages, to an award of the profits that it would have made on those other

investments. In particular, CalFed claimed that over time it would have replaced the maturing ARMs with other profitable loans and investments. As to the "forgone assets" claim, the trial court found that CalFed had failed "to explain credibly how it would have supported these highly profitable loans if it could have made them, or why they would have been highly profitable." The court explained that its finding on that issue was based on its discrediting the testimony of CalFed's expert as to the profitability of these unidentified assets. The court found persuasive the testimony of one of the government's experts, who pointed out that the bank was operating in a highly competitive environment at the time and that the acquisition of additional assets would not necessarily have yielded additional profits. In fact, as the court noted, CalFed's return on assets during the period 1990-96 was actually negative.

Summarizing its findings on the issue of causation, the trial court stated that the facts developed at trial did not support the basic premise of CalFed's theory-that postbreach provisions such as the increased capital maintenance requirements and the reduction of supervisory goodwill, which forced the bank to shrink, necessarily cost the bank money. For example, the court pointed out, CalFed lost $20 million in 1990 with $20 billion in assets, while it earned a profit during 1995-96 with only $15 billion in assets. The court concluded that "[s]hrinking the bank in the midst of a serious recession in fact was a very good idea for CalFed" and that CalFed therefore failed to prove with the requisite certainty that the breach caused it to lose profits that it would have obtained in the absence of the breach. Thus, as the court put it, CalFed "did not prove that losing goodwill or replacing it with tangible capital affected its profits adversely."

D

On appeal, CalFed focuses on the post-FIRREA sale of the ARMs and on the profits that it asserts it lost by being forced to sell those assets. CalFed contends that the trial court committed clear error in finding that it failed to prove a sufficient causal connection between the breach and CalFed's loss of profits on the ARMs that it claims it would have made in the absence of a breach. CalFed's task in challenging this intensely factual determination on appeal is an exacting one. First, CalFed faces a daunting standard of review in asking us to overturn factual findings made by the trial court after hearing six weeks of sharply conflicting evidence. *See Bluebonnet Sav. Bank, F.S.B.*, 266 F.3d at 1356 (causation is "a question of fact reviewed under the clear error standard"). Moreover, CalFed's theory of expectancy damages is one that we have characterized as "impractical for these [*Winstar* cases, and generally not susceptible to reasonable proof," noting that "given the speculative nature of such a damages claim, [such a claim] has yet to be successfully established in any *Winstar* case" and that "experience suggests that it is largely a waste of time and effort to attempt to prove such damages." *Glendale Fed. Bank, FSB*, 378 F.3d at 1313. After a detailed review of the evidence on which the court based its finding, we are not persuaded that CalFed has demonstrated that the trial court committed clear error.

CalFed asserts that the best evidence as to the critical question whether CalFed would have retained the ARMs in the absence of a breach is the testimony of CalFed's officers, who testified that if CalFed had not had to meet the post-FIRREA capital maintenance requirements, it would have retained the ARMs. CalFed argues that on the question of why the ARMs were sold, it was improper for the court to rely on the testimony of the government's experts rather than the testimony of CalFed's fact witnesses, who testified about their own intentions.

The fact-finder's freedom to consider, credit, and discount various items of evidence is not as narrow as CalFed suggests. The court, sitting as finder of fact, was entitled to weigh the credibility of CalFed's fact witnesses, taking into account their interest in the outcome of the litigation. At the same time, the court was entitled to consider the government's expert testimony to the extent that it shed light on the economics of finance and banking and thus helped explain why CalFed sold the ARMs following FIRREA's enactment. Although expert testimony lacking a sound scientific basis should be excluded, *see Daubert v. Merrell Dow Pharms., Inc.*, 509 U.S. 579 (1993), the expert testimony offered by the government in this case did not lack a sound scientific basis and therefore it did not constitute an abuse of discretion for the trial court to consider it, *see Seaboard Lumber Co. v. United States*, 308 F.3d 1283, 1301-02 (Fed. Cir. 2002).

The expert testimony on which the court relied in this case provided an explanation of why a bank such as CalFed might well have chosen to dispose of the ARMs, even in the absence of the breach, rather than retaining them, and why the sale of the ARMS did not necessarily result in a loss to CalFed. The expert testimony thus satisfied the requirement of Rule 702 of the Federal Rules of Evidence, which permits expert testimony to be admitted "to assist the trier of fact to understand the evidence or to determine a fact in issue." Accordingly, it was not improper for the court to rely on the government's expert testimony to assist it in making its factual findings on the causation issue.

One of the government's experts, Professor Daniel Fischel, testified extensively about the economics of capital requirements and the economic consequences of shedding assets in order to comply with capital requirements. With regard to CalFed's argument that the phasing out of supervisory goodwill deprived CalFed of the ability to

leverage its assets, Professor Fischel stated that the idea that "leverage creates wealth" is a fallacy:

> You lose the stream of income that you would have had if you held on to the asset, but at the same time you avoid the interest expense that you also would have had if you held on to the asset. And unless there's some reason to believe that you know something about these assets that the party on the other side of the transaction doesn't know, which isn't really very likely in a case of something like a mortgage loan or mortgagebacked security, the asset will sell for its fair value and the income that you lose will exactly offset, certainly as a first approximation, the interest expense that's avoided.

Moreover, Professor Fischel explained that CalFed's behavior was inconsistent with its theory that the sale of the ARMs deprived it of the ability to leverage its assets in a way that would generate large profits. In particular, he found it highly significant that for periods both before and after the enactment of FIRREA, CalFed sold roughly the same number of ARMs. He explained that if the bank's "less leverage, less profits" hypothesis were true, CalFed would have stood to lose just as much from the sale of ARMs before the breach as it claimed to have lost afterwards.

In light of the evidence that selling ARMs was part of CalFed's normal business strategy, Professor Fischel concluded that CalFed's explanation at trial for why it sold ARMs before the enactment of FIRREA-that it sold the ARMs as a means of controlling growth-did not provide a rational basis for distinguishing the pre-FIRREA ARMs sales from the post-FIRREA sales. Professor Fischel explained that if CalFed had regarded the ARMs as highly profitable, as CalFed's expert contended, it would have made more sense

for CalFed to have originated fewer high-risk loans and to have purchased fewer high-risk assets, rather than selling the ARMs.

Finally, Professor Fischel, together with another government expert, Dr. William Hamm, criticized the analysis of CalFed's expert, Professor Christopher James, who testified in support of CalFed's claim for lost profits. Professor Fischel and Dr. Hamm criticized various details of Professor James's model, as well as Professor James's assumptions about what CalFed would have done with the profits it would have earned from the ARMs, which did not comport with what CalFed was, in reality, doing at the time. Professor Fischel stated that Professor James's model depended on CalFed's investing much of its capital in mortgage-backed securities because those assets were very profitable. But Professor Fischel said that those securities were not in fact highly profitable. Instead, he explained that they were used to strengthen the bank's regulatory capital position because they had a lower risk weighting and thus would not be used to make a high profit. In fact, at that time CalFed was not investing in the lowrisk mortgage-backed securities but instead was investing in high-risk loans. Thus, Professor Fischel concluded, Professor James's model of causation simply did not conform to the reality of what CalFed was doing at the time FIRREA was enacted. He explained that it is more likely that, in the absence of a breach, CalFed would have continued to invest in high risk loans and not the safer mortgage-backed securities that Professor James assumes it would have invested in and profited from.

In addition to the testimony of its officers and its expert, CalFed relied on certain documentary evidence to support its claim that the breach forced it to sell the ARMs, which it otherwise would have retained. On appeal, CalFed points in particular to its 1991 quarterly report to shareholders, which

stated that CalFed "reduc[ed] . . . the level of interest earning assets as the Bank continues to downsize" and that "[t]he decrease in interest earning assets is primarily the result of the sale by the Bank of certain mortgage-backed securities and loans." The report continued: "The reduction in the bank's assets was part of the Bank's continuing efforts to comply with its regulatory capital requirements. As discussed in the section *Capital Requirements*, the regulatory capital required of the Bank is scheduled to increase over the next three years." While that report is evidence that CalFed was downsizing during that period, at least in part because of regulatory capital requirements, the report does not support CalFed's contention that it was required to sell the ARMs and that absent the breach it would have retained those assets.

Other documentary evidence on which CalFed relies fails to provide support for CalFed's basic thesis on causation. For example, CalFed's 1990 10-K report stated that CalFed had sold "certain mortgage-backed securities" and that this "reduction of [CalFed's] assets was one of the contributing factors that enabled it to meet the increased regulatory capital requirements of FIRREA." Those statements, however, do not refer to the ARMs and do not suggest that the breach compelled CalFed to sell the ARMs. Moreover, the evidence indicated that the recession and increases in capital requirements that were not related to the breach were responsible for the vast bulk of the deterioration in CalFed's regulatory capital position. Documentary references to the need to sell assets in order to achieve capital compliance therefore do not establish that the breach forced CalFed to sell the ARMs.

The contents of certain other documents, and the absence of documentary support for CalFed's thesis that the breach forced it to sell the ARMs, buttress the trial court's conclusion on causation. For example, the court referred to a

lengthy statement made by a CalFed vice-president a year after the breach in an effort to explain to shareholders why CalFed's stock price was dropping. The court found it significant that throughout the lengthy and detailed statement, the CalFed representative made no reference to the sales of ARMs, whether because of the phase-out of supervisory goodwill or otherwise.

Moreover, circulars that were published in 1995 and 1996 when CalFed was seeking to sell shares in this litigation contained detailed accounts of CalFed's theory of recovery. Yet those circulars did not specify the required sale of ARMs as being among the grounds for CalFed's claim of damages, even though the circulars identified other injuries that allegedly flowed from the breach and other specific assets that CalFed had allegedly sold as a result of the breach. More generally, as the trial court noted, there was a paucity of documentary support for CalFed's contention that the breach compelled it to sell the ARMs, even though if CalFed had been forced to sell those assets against its will because of the breach, one would expect to find ample contemporaneous documentary evidence of that fact.

In sum, we conclude that the trial court did not commit clear error in finding that CalFed did not establish that it would have kept ARMs in the absence of the breach and thereby would have made profits that, because of the breach, it was forced to forgo. Because the court reasonably concluded that the documentary evidence in the case did not establish that the breach caused the shrinking of the bank and the sale of the ARMs, and because it was permissible for the court to discount the testimony of the bank's officers in light of the contrary evidence offered by the government, we uphold the trial court's finding that CalFed failed to meet its burden on the issue of causation.

II

We turn next to CalFed's claim that it is entitled to prejudgment interest on the $23 million that it was awarded as the cost of replacing the regulatory capital disallowed as a result of the enactment of FIRREA.

By statute, an award of prejudgment interest "on a claim against the United States shall be allowed in a judgment of the United States Court of Federal Claims" only if the contract or an Act of Congress "expressly provide for payment thereof." 28 U.S.C. § 2516(a). This is not an action against a federal agency as such, but is an action against the United States based on a breach of contract caused by the enactment of legislation. Because the action is based on a claim against the United States and is brought in the Court of Federal Claims, the availability of interest is directly governed by section 2516(a), not by the statutes applicable to suits against individual agencies. Because neither any of the contracts in suit nor any pertinent statute expressly provides for the payment of interest, the trial court correctly held that interest is not available to CalFed.

This case is not governed by an analogy to the principle that interest is available against the United States in takings cases. *See Library of Congress v. Shaw*, 478 U.S. 310, 317 n.5 (1986). The grant of interest in those cases is regarded as a necessary component of the constitutional imperative of "just compensation" that must be paid pursuant to the Takings Clause of the Constitution to any person whose property has been taken for a public purpose. *Shoshone Tribe of Indians v. United States*, 299 U.S. 476, 497 (1937). In this contract case brought under the Tucker Act against the United States, there is no such constitutional compulsion for the payment of interest, and therefore the statutory "no interest" rule applies.

Even apart from the restraints of 28 U.S.C. § 2516(a), we would find no waiver of sovereign immunity as to FSLIC

and the FHLBB for the grant of interest. Although acknowledging that sovereign immunity generally precludes awards of interest against federal agencies, CalFed argues that Congress waived sovereign immunity in the case of FSLIC through the "sue and be sued" clause found in FSLIC's organic statute, 12 U.S.C. §§ 1725(a)-(b), 1726(a) (1988). CalFed contends that the Supreme Court's decision in *Loeffler v. Frank*, 486 U.S. 549 (1988), which held that a "sue and be sued" clause in the Postal Service's organic statute constituted a waiver of sovereign immunity, should apply equally to FSLIC.

We disagree. The Supreme Court in *Loeffler* focused on the extent to which Congress intended for the Postal Service to function as a commercial, not a governmental entity. By contrast, the FHLBB and FSLIC, like their successors the Resolution Trust Corporation and the Federal Deposit Insurance Corporation, perform distinctly governmental regulatory functions. On that ground the other courts of appeals that have addressed the issue have rejected the argument that a "sue and be sued" clause in the organic statutes of those agencies waives sovereign immunity with respect to the grant of prejudgment interest. *See Battista v. Fed. Deposit Ins. Corp.*, 195 F.3d 1113, 1120 (9th Cir. 1999); *Far West Fed. Bank v. Office of Thrift Supervision*, 119 F.3d 1358, 1366 (9th Cir. 1997); *Resolution Trust Corp. v. Fed. Sav. & Loan Ins. Corp.*, 25 F.3d 1493, 1506 (10th Cir. 1994); *Spawn v. West. Bank-Westheimer*, 989 F.2d 830, 835-38 (5th Cir. 1993). We see no reason to part company with the other circuits on this issue.

III

In its cross-appeal, the government seeks to reopen the issue of liability with respect to two of the thrifts that CalFed acquired in the early 1980s-the Brentwood Savings and Loan Association, acquired in 1982, and the Family Savings and Loan Association, acquired in 1983. CalFed acquired the

Brentwood and Family thrifts without the kind of formal acquisition agreement with FSLIC that accompanied many of the thrift acquisitions during the 1980s. The government now argues (1) that there was "no contractual intent, and hence, no contract" resulting from the regulatory approval of the Brentwood and Family acquisitions; and (2) that even if the elements of contract were present, representatives of the FHLBB and FSLIC did not have the statutory authority to enter into contracts having the effect of imposing binding obligations on the United States.

The argument that there was no intent to contract with respect to the two challenged acquisitions was addressed and rejected by this court in the prior appeal in this case. *See* 245 F.3d at 1346. Based on law of the case principles, we decline to reconsider that issue. We note that the government does not offer any reason that the law of the case doctrine is inapplicable, but simply asserts that "[t]o the extent the law of the case doctrine prevents a re-examination" of our previous ruling on that issue, "the issue will have to await any Supreme Court review."

In the last appeal, we also held that the FHLBB and FSLIC representatives were authorized to enter into the contracts at issue here. With respect to that issue, the government contends that law of the case principles do not apply, because the authority of our prior decision in this case has been undermined by an intervening en banc decision of this court, *Schism v. United States*, 316 F.3d 1259 (Fed. Cir. 2002).

In *Schism*, a group of servicemen sued for breach of contract arising from military recruiters' promises that the servicemen would be provided free lifetime medical care for them and their dependents. We held that no statute gave the recruiters authority to make such promises and that the promises therefore did not give rise to a binding contract between the servicemen and the United States.

The principles of *Schism* do not apply in this case, because the FHLBB and FSLIC had authority to regulate capital requirements for savings and loan institutions and to enter into agreements with acquirers of insolvent thrifts under which minimum capital requirements would be adjusted on a case-by-case basis. We so held in the prior appeal in this case, 249 F.3d at 1347, and the Supreme Court reached the same conclusion in *Winstar*, The plurality opinion in *Winstar* so stated:

> There is no question . . . that the Bank Board and FSLIC had ample statutory authority to do what the Court of Federal Claims and the Federal Circuit found they did do, that is, promise to permit respondents to count supervisory goodwill and capital credits toward regulatory capital and to pay respondents' damages if that performance became impossible.

518 U.S. at 890. The plurality opinion further explained that the statutory authority extended "to contracts governing treatment of regulatory capital," and that Congress had specifically acknowledged FSLIC's authority to permit thrifts to count goodwill toward capital requirements when it amended the National Housing Act in 1987. *Id.* at 890-91. Based on that authority, the plurality opinion concluded that there is "no serious question that FSLIC (and the Bank Board acting through it) was authorized to make the contracts at issue," the substance of which was similar to the contracts at issue in this case. *Id.* at 891. The three concurring justices agreed with that portion of the plurality's analysis, stating that "the contracts at issue in this case gave rise to an obligation on the part of the Government to afford respondents favorable accounting treatment." *Id.* at 919 (Scalia, J., concurring in the judgment).

Our decision in *Schism* is not contrary to the Supreme Court's decision in *Winstar*, because the two cases involve entirely different statutory schemes. In *Schism* we addressed the general housekeeping statute that grants the head of every executive and military department the authority to "prescribe regulations for the government of his department, the conduct of his employees, the distribution and performance of its business, and the custody, use, and preservation of its records, papers, and property." 5 U.S.C. § 301. We held that the general housekeeping statute was not sufficiently specific to authorize military recruiters to make promises regarding the provision of free lifetime medical care. *Schism*, 316 F.3d at 1279-80. The general housekeeping statute, however, is far less comprehensive and specific than the statutory authorization of the FHLBB and FSLIC. Even as of the time of the Brentwood and Family acquisitions, Congress gave those agencies various forms of regulatory authority over the thrift industry, including the authority to impose capital reserve requirements in a form satisfactory to FSLIC, to dispose of defaulting thrifts as they deem appropriate, and to enter into contracts in support of their regulatory responsibilities. *See* 12 U.S.C. §§ 1725(c)(3), 1726, 1729(b), (f), 1730a(m) (1982).

Even if we considered the analysis of the military recruiters' contracting authority in *Schism* to be at odds with the Supreme Court's analysis of the authority of FSLIC and the FHLBB to enter into contracts with acquiring thrifts in which FSLIC or the FHLBB made promises regarding capital maintenance requirements and the amortization of supervisory goodwill, we would not be free to reject the Supreme Court's statutory authority analysis in *Winstar* in favor of the rationale of our decision in *Schism*. Accordingly, we reject the government's argument in its cross-appeal that the FHLBB lacked the authority to enter into the contracts regarding the Brentwood and Family acquisitions.

Each party shall bear its own costs for this appeal.

AFFIRMED.

APPENDIX G

IN THE UNITED STATES COURT
OF FEDERAL CLAIMS

* * * * * * * * * * * * * * *

CALIFORNIA FEDERAL BANK,
A Federal Savings Bank,

Plaintiff,

v.

UNITED STATES of America,

Defendant.

No. 92-138 C

Dec. 17, 2002

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OPINION

HODGES, Judge.

This case is on remand from the United States Court of Appeals for the Federal Circuit. *See California Fed. Bank, FSB v. United States*, 245 F.3d 1342 (Fed. Cir. 2001). The Government breached its contract with CalFed to treat supervisory goodwill as regulatory capital and to amortize its goodwill over a period of thirty years. *California Fed. Bank v. United States*, 39 Fed. Cl. 753 (1997), *aff'd*, 245 F.3d 1342 (Fed. Cir. 2001). The issue on remand is whether this breach entitles plaintiff to expectancy damages in the form of lost profits. CalFed did not prove causation, foreseeability, or reasonable certainty of damages at trial.[1] Its lost profits model was not credible.

1. CAUSATION

Defendant's breach did not cause measurable damages to plaintiff. If loss of supervisory goodwill forced plaintiff to "shrink the bank" to improve its capital ratios, or to raise capital, the bank was not harmed by the process.[2] Plaintiff improved its tangible capital position because it phased out supervisory goodwill.

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1 *See, e.g., Energy Capital Corp. v. United States*, 47 Fed. Cl. 382 (2000), *aff'd in part, rev'd in part*, 302 F.3d 1314 (Fed. Cir. 2002).

2 "Plaintiff did not prove that shrinking the bank was a result of the breach, or even that it was harmful. It may have been the result of prudent management decisions." *California Fed. Bank v. United States*, 43 Fed. Cl. 445, 459 (1999).

2. FORESEEABILITY

The Government promised plaintiff that it could count goodwill as regulatory capital but not that the bank would produce profits as a result. A severe real estate recession in California caused plaintiff financial problems after the breach. Defendant could not have foreseen the recession or its effects when it entered the contract with CalFed, and it could not have foreseen that years later plaintiff would choose to sell assets that it now claims would have been profitable.

3. REASONABLE CERTAINTY

Plaintiff did not show that the bank's sale of assets such as California Thrift and Loan (CTL) or its adjustable rate mortgages (ARMs) were related to defendant's breach. CalFed's chief executive officer wanted to sell CTL because it was an automobile finance company that did not fit into his "back to basics strategy." The bank sold adjustable rate mortgages because selling loans was a profitable business in which it had a competitive advantage.

I. BACKGROUND

Congress created the Federal Deposit Insurance Corporation and the Federal Savings and Loan Insurance Corporation in 1933 and 1934, respectively. The purpose of these agencies was to insure qualified deposits in banks and savings and loans. The FSLIC paid billions of dollars to depositors of failed savings and loans during the 1980's. The agency charged higher insurance premiums to recover from insolvency and to replenish the Fund. Many savings and loans associations tried to leave FSLIC and join FDIC for that reason. Congress tried in 1987 to prevent savings and loans from leaving the FSLIC and to save the insurance fund. *See* Competitive Equality Banking Act of 1987, Pub. L. 100-86, 101 Stat. I 52.

When this effort failed, Congress enacted the Financial Institution Reform, Recovery and Enforcement Act of 1989, Pub. L. 107-73, 103 Stat. 183. FIRREA abolished FSLIC and gave FDIC the responsibility for both funds. The law also eliminated or changed agreements that some savings institutions had with the Government. This court found that Congress breached these agreements when it passed FIRREA. The Federal Circuit and the Supreme Court agreed. *See Winstar Corp. v. United States*, 64 F.3d 1531 (Fed. Cir. 1995) (en banc), and *United States v. Winstar Corp.*, 518 U.S. 839, (1996). All Winstar-related cases were remanded to this court for further proceedings. Chief Judge Smith ruled for CalFed on summary judgment in 1998 and transferred the case to us for trial on damages.

A. The First Trial

Lost Profits

CalFed sought lost profits, restitution, and "wounded bank" damages in its breach of contract case against the United States in February 1999. Proof of expectancy damages was the topic of several pre-trial hearings in October and November 1998. We were concerned that the bank's lost profits claim relied not on documentary evidence but on expert testimony using investment strategies informed by hindsight. We reviewed CalFed's business plans, board resolutions, minutes, internal memoranda, and a lengthy Appendix containing corporate financial data, SEC filings, and similar material. A pre-trial order issued in November 1998 stated:

> Defendant knew that breaching this agreement would cause plaintiff to adjust its capital ratio. That is, it knew that plaintiff would have to reduce its assets or increase its capital. But it could not foresee what effect this adjustment would have on plaintiff's profits. Banking was a volatile and dynamic business . . . [and]

> particularly speculative in these circumstances .... The Government promised to permit the use of goodwill as capital, but it did not guarantee plaintiff that its use of the additional leverage would be profitable.

California Fed. Bank v. United States, No. 92-138C (Fed. Cl. November 12, 1998).

Wounded Bank Damages; Restitution Claim Plaintiff argued at trial that bad publicity and other problems resulting from defendant's breach caused its cost of funds, deposit insurance premiums, and other assessments to increase, and made it difficult for the bank to compete. These "wounded bank" damages totaled $285 million. The bank also argued that it was entitled to nearly a billion dollars in restitution for its loss of the right to count supervisory goodwill as capital.

We issued an opinion in April 1999 denying both the wounded bank damages and the restitution claim. *California Fed. Bank v. United States*, 43 Fed. Cl. 445 (1999). A $23 million judgment for flotation costs reimbursed plaintiff's cost of raising new capital to replace the goodwill that it phased out because of defendant's breach. *Id.*

B. The Federal Circuit

The Federal Circuit affirmed the ruling on restitution and the $23 million judgment for flotation costs. Plaintiff did not appeal the denial of wounded bank damages. The court remanded plaintiff's lost profits case because CalFed had provided evidence of "[b]oth the existence of lost profits and their quantum, [and these are] factual matters that should not be decided on summary judgment if material facts are in dispute." *California Fed. Bank, FSB v. United States*, 245 F.3d 1342, 1350 (2001) (citing RCFC 56(c)).

The Circuit noted plaintiff's allegations that it sold nearly 25,000 adjustable rate mortgages worth approximately $4 billion because of the breach, and that it was "forced to

sell a profitable business unit, California Thrift & Loan, to meet its capital requirements." *California Fed. Bank, FSB*, 245 F.3d at 1350. These assets and a third category of investments called "other foregone assets" comprise the bank's lost profits model.

C. Trial on Remand

We completed six weeks of testimony in October 2002, followed by rebuttal and sur-rebuttal cases. Plaintiff offered one expert witness and several fact witnesses during the trial. The expert, Professor Christopher James, relied extensively on representations from bank management in crafting his lost profits model. Management's factual testimony was not sufficiently reliable to support his conclusions, however. Professor James was a persistent advocate for plaintiff on the merits. His opinions generally were not persuasive compared with those of defendant's experts, to the extent that they were in conflict.

Several of the bank's fact witnesses testified that absent the breach they would have retained profitable assets that Professor James uses in his model. These retrospective strategies were not always consistent with the bank's stated investment philosophy at the time. Professor James accepted such assertions uncritically.

II. DISCUSSION

The breaching provisions of FIRREA precluded the use of goodwill as regulatory capital, thereby reducing the bank's capital ratios. Plaintiff had the options of raising new capital to improve its ratios or shrinking the bank's assets, or both. CalFed raised $800 million in new capital during the period 1989--1994. The total amount of goodwill phased out was

not entirely clear at the second trial. Plaintiff's expert testified that $300 million was a reasonable approximation.[3]

Plaintiff alleges that FIRREA forced the sale of specific assets that it would have kept and that would have been profitable. These "foregone assets" are the basis for plaintiff's lost profits model. The foregone assets consist of (1) nearly 25,000 adjustable rate mortgages; (2) a finance company called California Thrift & Loan; and (3) "Other Foregone Assets."[4] Plaintiff's lost profits model traces the profitability of the forgone assets in the hands of their purchasers and assumes additional profits from these proceeds.[5]

CalFed likely would have sold most of its adjustable rate mortgages irrespective of the breach. It would have sold California Thrift & Loan as well. CTL did not fit

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[3] We entered a $23 million judgment after the first trial to compensate plaintiff for its cost of raising approximately $400 million to replace $390 million of lost goodwill. *California Fed. Bank v. United States*, 43 Fed. Cl. 445, 460 (1999).

[4] "Forgone Assets" describes the three categories of lost profits in plaintiff's model. "Other Forgone Assets" is a nebulous assortment of allegedly lost investment opportunities.

[5] *See, e.g., Neely v. United States*, 152 Ct. Cl. 137, 285 F.2d 438 (1961), where defendant breached its agreement to allow plaintiff to strip mine coal. The plaintiff viewed strip mining as being the only economical method in that circumstance, so it assigned the lease to another company and later sued for lost profits. The court held that "the profit realized from these operations, if, indeed, there were profits, would furnish some basis for a fairly reliable estimate of what plaintiff's profits would have been." *Id.* at 147, 285 F.2d 438.

management's "back-to-basics strategy." Plaintiff did not prove that it was harmed by shrinking the bank or by raising new capital. The bank's prudent business decisions enabled it to survive a serious real estate recession and to prosper.

Plaintiff did not prove that it would have made additional profits absent the breach. *See, e.g., Energy Capital Corp. v. United States*, 302 F.3d 1314 (Fed. Cir. 2002) (plaintiff was "required to demonstrate its entitlement to lost profits by showing the same elements that any business must show: (1) causation, (2) foreseeability, and (3) reasonable certainty.") (citation omitted). We could not make a "fairly reliable estimate" of lost profits. *Neely v. United States*, 152 Ct. Cl. 137, 147, 285 F.2d 438, 443 (1961).

A. Plaintiff's Lost Profits Model

Professor James' model is based on the difference between assets of the actual bank and the assumed assets of the bank if no breach had occurred. These "incremental assets" make up the difference between the actual bank's real world assets and the assets of a no-breach bank with supervisory goodwill intact.

Information concerning profits from CTL and the divested ARMs is available, at least in the hands of the purchasers, but profits from "other foregone assets" are entirely speculative. They are determined by applying a one percent return on investment, which cannot be documented, to "other foregone assets" that are not defined. The one percent spread is based on an assumption that Professor James termed "conservative," explaining that he "looked at specific investments, mortgage-backed securities, certainly the ARMs, the kinds of assets that are consistent with the back-to-basics strategy."

One problem with the model's "other foregone assets" is how they would have been funded. Professor James uses the

three-month Merrill Lynch certificate of deposit rate plus fifty basis points as a "proxy" for funding these assets. Management wanted to avoid such brokered deposits and to use retail deposits as much as possible.[6]

Professor James inflated profits on the "other foregone assets" by using short-term certificates of deposit for the funding proxy. Retail deposits and longer-term CDs would have been more costly sources of funds. Professor James used a funding proxy in his model that repriced frequently because he knows that interest rates declined during the early 1990's. In reality, the bank thought that interest rates were going to rise during that period, and would not have taken such a gamble.

Dr. William Hamm was one of defendant's experts. He showed that Professor James' proxy is purely speculative. He presented a detailed and authoritative explanation of why the Merrill Lynch rate was not an appropriate proxy. Plaintiff responded that such criticism "ignores the testimony of the fact witnesses." This was a common response to expert criticism of Professor James' model throughout the trial. Defendant's experts were asked many times on cross whether they were in a better position than management to know what the bank would have done in the non-breach world.

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[6] For example, Mr. Dale Cohen testified that "[t]he back-to-basics strategy called for an emphasis on retail deposits. So to the extent that retail deposits could be increased, then other wholesale funding sources would have been reduced, and brokered deposits would have been something that would have been considered to be reduced."

B. California Thrift & Loan

Plaintiff argued on appeal that it was "forced to sell a profitable business unit, California Thrift & Loan, to meet its capital requirements." *California Fed. Bank, FSB*, 245 F.3d at 1350. CTL was an automobile finance subsidiary of the holding company that owned CalFed. Mr. Jerry St. Dennis, who became chief executive officer of CalFed in 1990, wanted to sell CTL because it did not fit into his "back-to-basics" plan for the company. He wanted to return the bank to traditional lending strategies that had made it successful. He did not view the automobile finance company as such a business.

The Office of Thrift Supervision required the bank to submit a plan in 1991 to improve its capital ratios. CalFed suggested that it could raise the capital by transferring CTL from the holding company to the bank and selling it. The bank achieved its capital ratio goals in 1993, so it was no longer necessary to sell CTL. The 1991 agreement with OTS released CalFed from all further obligations once the capital goals were reached. Mr. St. Dennis sold CTL a few months later anyway, despite objections from the board of directors. He testified that he felt a "moral obligation" to the regulators to sell CTL.

Mr. St. Dennis' representation that he sold CTL because he felt a moral obligation to the regulators was not persuasive. Moreover, the term "moral obligation" suggests the absence of a legal obligation. The decision to sell a profitable business on such a basis was one that defendant could not have foreseen. *See, e.g., Hughes Communications Galaxy, Inc. v. United States*, 271 F.3d 1060, 1071 (Fed. Cir. 2001) (independent business decision to obtain launch insurance was intervening cause that precluded award of damages) (citing *Myerle v. United States*, 33 Ct. Cl. 1, 27, 1800 WL 2024 (1897)).

Mr. St. Dennis wanted to sell the automobile financing business. He may have used the agreement with OTS to help him convince the board of directors. In any event, plaintiff was not forced to sell CTL because of the breach.[7]

C. Adjustable Rate Mortgages

The Federal Circuit noted that CalFed "provided specific documentation of 24,664 single-family adjustable rate mortgages worth approximately $4 billion that it claims it was forced to sell to remain in capital compliance after the breach." *California Fed. Bank, FSB*, 245 F.3d 1342, 1349 2(001). Plaintiff "traced the actual post-sale performance of these loans and arrived at lost profits of $317 million attributable to those sales." *Id.* at 1349-50.

Plaintiff also sold approximately $4 billion worth of adjustable rate mortgages before the breach. The bank's business was selling loans, before and after the breach. Management witnesses testified at trial that they sold billions of dollars worth of ARMs before the breach only because of a need to "control growth."[8]

Selling ARMs was a profitable business for CalFed. Former CEO William Callendar wrote a letter to regulators in July 1991 stating that originating mortgage loans and selling them into the secondary market "should be viewed as an

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[7] Mr. St. Dennis tried to sell CTL in 1991 and 1992 but found little interest. The 1993 Board was opposed to the sale. He testified, "I told them we already had the authority to sell it, so it really wasn't an issue for them (the board) to decide."

[8] It seemed reasonable that both the bank and the regulators would want to avoid uncontrolled growth, but we saw little evidence of a systematic or measurable policy in this regard.

integral part of [CalFed's] operations . . . ."[9] Mr. St. Dennis testified that the bank had a competitive advantage in selling loans after the breach as well as before. He acknowledged that the bank's business plan for originating and selling ARMs did not change after the breach.[10]

Plaintiff was able to trace the post-sale performance of the mortgages that it sold because the bank retained servicing rights to the loans. That is, it collected payments, handled past-dues, and instituted foreclosure proceedings when necessary. Dr. Hamm testified that such performance information does not establish the revenue that the loans would have produced had they remained on CalFed's books.

Professor James filed corrected and supplementary expert reports to address errors concerning credit losses on the divested ARMs. His model does not account for nonperforming loans. He testified that some nonperforming loans would cure, but that did not appear to justify ignoring all nonperforming loans. Professor James explained that any overstatement of interest income was "comfortably offset" by

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[9] "The bank has for several years been in the business of originating mortgage loans and selling them into the secondary market; one effective means of selling loans has been to securitize and create [mortgage-backed securities] from loans originated by the Bank . . . . [T]hese sales activities should be viewed as an integral part of [the Bank's] operations, not as part of its activities to maintain short-term liquidity."

[10] The bank's 1990 business plan included the following: "Sales of mortgage loans will be $1 billion in 1990, as part of the plan to control growth in total assets, as well as to take advantage of CalFed's capacity to originate a large volume of fixed and adjustable mortgage loans . . . ."

his overstatement of credit losses in the model.[11] Assuming that errors in a lost profits model would tend to offset each other seemed to be a haphazard method for an expert to use in approaching such an important case as this one.

Professor James did not identify liabilities that the bank would have used to finance the ARMs had they not been sold. According to Dr. Hamm, without such information, "any opinion about lost profits is speculative .... [T]he spread that Professor James calculates on these ARMs, it's not a product of analysis; it's a product of assumption ...."

CalFed's fact witnesses testified that management worried almost daily about the impact of phasing out goodwill, yet no memorandum in the record documents such concerns. Plaintiff's witnesses testified about regular meetings to discuss the problem, but did not submit notes of such meetings, minutes, internal memoranda, or even memos to file. Not one contemporaneous written reference is made to selling the ARM portfolio because of the phase-out of goodwill.[12]

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[11] Some potentially important information concerning credit losses was not made available to defendant in discovery. Defendant moved for sanctions and for an inference by the court that the information would have been adverse to plaintiff's case. We have not addressed sanctions or made such inferences.

[12] Defendant played a video during the trial of Mr. James Hurley, a senior vice president of the bank, explaining to shareholders why CalFed's stock price was dropping. We include a transcript of the video here because of what Mr. Hurley does not tell the shareholders. He makes no reference to selling billions of dollars of ARMs because of thephase-out of supervisory goodwill, or for any other reason. A year after the breach, Mr. Hurley makes no reference FIRREA at all:

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(INTERVIEWER): Obviously right now you're spending a lot of time talking to people on the phone about our current stock price. What do you see as the crux of the issue right now?
(MR. HURLEY): First of all, you can tell any member of our division in the hallway by the permanent crook in their neck from answering the telephone over the past six weeks or so. Calls have been particularly heavy, and we've taken probably as many as 100, 130 calls a week from investors of all kinds, and news media and so on. It's been a tough time, because there is so much embedded pessimism, a lot of it unjustified, in the marketplace about CalFed stock. This pessimism has developed as a result of an international issue, the Persian Gulf crisis, national issues, the federal budget and interest rates, regional issues, such as the California real estate economy, and some specific issues that relate directly to CalFed. The crisis in the Persian Gulf has caused investors to defer decisions on major investments such as homes. The number of borrowers has dropped off very, very sharply. So there's still interest on the part of consumers in the big ticket purchases, the home and the car, but they have deferred their purchases to some extent, to a large extent perhaps, until such time as there's a resolution in the Persian Gulf. The national issue, the federal budget, looks like at this point anyway the president may have achieved passage of that. Depends on what Congress does, and as we sit here, there's still arguments on both sides of the Hill about whether the budget is the right one for us. But that is going to have some impact on whether consumers are willing to spend their money or continue to defer spending it until such time as we reach a calmer state. The regional issue, and this is probably the overriding issue with respect to CalFed stock, is the California real estate market. As we know, Guy, on Wall Street, perception is reality. And this pessimism is exacting a toll on all financial services stocks today. The California real estate environment is

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perhaps the most important element in this whole issue of pessimism over financial services stocks. And CalFed in particular. Eastern investors who have been battered by a true real estate recession themselves, which started in the commercial office building market and moved into residential, multifamily and single family residential markets, has really hurt them back there. And the perception by many institutional investors in the east is, is that the weakness in the California commercial office building market is going to migrate into the multifamily and residential real estate markets much in the way it did in New York. We see no evidence of this at all. As you know, California has always been the stronghold of real estate values, and it still deserves that appellation with respect to the residential and multifamily markets.
(QUESTION): So the general factors, international, national and regional, will affect all financial institutions, not just CalFed? It explains the depression of stock, but not completely. You had mentioned some of the specific instances correlated to CalFed. Can you talk about that a minute?
(ANSWER): Sure. It just has to be said out of a sense of fairness, Guy, that there are some specific issues that are motivating investors to devalue CalFed's stock other than the stock of our competitors. And these issues represent the margin between how badly we've been battered and how badly our competitors have been battered. One of those issues is the issue of the so-called New York loan. We have $160 million loan in New York that we made in 1983 to a world class borrower, a blue chip borrower, and the loan has performed absolutely textbook perfect, up until the time when in February of this year, one of the major tenants of this building, a household word by the name of Drexel Burnham Lambert, filed for bankruptcy, and at that time they moved out of the building and pinched off some of the cash flow to the borrower. The borrower has kept the loan current right up to now,

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Most of the bank's residential one-to-four family loans were located in Southern California, which was more severely affected by the recession than any other area. These loans were put on the books during 1988--1991, and they were highly vulnerable to delinquencies. The bank sold these loans at a profit after the breach, and now claims the phase-out of goodwill as the reason.

While plaintiff was selling ARMs after the breach, it was putting higher-risk loans on the books, including consumer loans, construction loans, and commercial loans.[13] CalFed

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right up to snuff, and he insists that the last thing he wants to do is see this loan come back to us. We believe that's the case, because he has an international reputation to protect. It would be too glib to say we're not worried about this loan. We're watching it very, very carefully. But the anxiety over this loan is exaggerated by the real estate--weakness in the real estate markets.
(QUESTION): What else?
(ANSWER): The other issue is $125 million in bonds that CalFed, Inc. issued in 1986. These bonds are redeemable in February of 1993, which is a long time away, but in today's pessimistic environment, investors don't look at the calendar longer than today or next week. So there has developed a sense of anxiety on the part of some investors as to whether or not CalFed can stand behind these bonds. There is absolutely no question in our minds that we'll be able to hold up our end of the bargain on these bonds.
(END OF VIDEO)

[13] Relatively higher risk loans require higher capital ratios. Mr. Gary Brummett explained that assets are assigned levels of risk by the regulators and require varying capital ratios to support them. For example, treasury bills are zero percent risk-weighted, while single-family mortgage loans were fifty percent during this period.

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referred to the divested ARMs at trial as its "crown jewels," and portrayed their sale as a desperation move necessitated by their liquidity and their certain value. Plaintiff could have remained in capital compliance without selling all of the ARMs, however. The bank likely would have sold many or most of its adjustable rate mortgages had the breach not occurred.[14]

D. Other Foregone Assets

The largest category of alleged lost profits in Professor James' model is $253 million of "other foregone assets." These are damages that plaintiff claims it suffered because the breach required it to "forego making highly profitable loans . . . ." *California Fed. Bank, FSB v. United States*, 245 F.3d 1342, 1349 (Fed. Cir. 2001). CalFed asserted that it would have retained all the divested ARMs absent the breach. Mr. Brummett testified that the portfolio would have diminished over time as the loans matured, and that the bank would have replaced them with profitable loans and investments. CalFed would have originated new loans, purchased whole loans or mortgage-backed securities on the secondary market, or invested in other market securities.

We could not determine during the trial what assets were included in this category. Plaintiff could not explain credibly how it would have supported these highly profitable loans if

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Property loans, commercial banking loans, and direct real estate investments were one hundred percent risk-weighted.

[14] The bank had a number of good business reasons to sell the ARMs. For example, management wanted a higher ratio of tangible net worth to tangible assets, which the sale accomplished. Also, Professor James' report shows that the bank recorded capital gains of $28 million from the sale, which it used to offset losses.

it could have made them, or why they would have been highly profitable. Professor James projected a return of one percent on all "other foregone assets."[15] Evidently these profits would have been added to retained earnings, which then would have been used to support the new assets that plaintiff claims it had to forego because of the breach.[16] Though Professor James could not identify these other foregone assets, his model assumes that they will be consistently profitable for forty years.[17]

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[15] Plaintiff's historic return on assets showed a maximum of .72%, and an average of negative .57% during the period 1990-1996. Professor James did not explain why he expected the bank to make an average return on assets of one percent through 2022 in light of this information except that it was "reasonable," and even "conservative."

[16] Retained earnings would cost the bank less than retail deposits, or other interest-bearing liabilities that would have reduced plaintiff's profits had Professor James used those sources instead.

[17] Dr. Hamm testified that it was unreasonable to assume a one percent return on assets for a number of reasons. As one example, market factors would limit the bank's opportunities to add profitable assets. The record of this trial contains many references to the highly competitive environment in which the bank was operating at the time. Dr. Hamm's emphasis on the importance of distinguishing between assets and profitable assets, and growth and profitable growth, was persuasive. Mr. St. Dennis seemed to agree when he stated that "growth is not the objective-profitability is the objective."

III. LEGAL STANDARDS

The Federal Circuit recently summarized the law on expectancy damages in *Energy Capital Corp. v. United States*, 302 F.3d 1314 (Fed. Cir. 2002):

> To recover lost profits for a breach of contract, the plaintiff must establish by a preponderance of the evidence, *see Knapp Shoes, Inc. v. Sylvania Shoe Mfg. Corp.*, 72 F.3d 190, 204 (1st Cir. 1995), that: (1) the loss was the proximate result of the breach; (2) the loss of profits caused by the breach was within the contemplation of the parties because the loss was foreseeable or because the defaulting party had knowledge of special circumstances at the time of contracting; and (3) a sufficient basis exists for estimating the amount of lost profits with reasonable certainty. *See Chain Belt Co. v. United States*, 115 F. Supp. 701, 714, 127 Ct. Cl. 38, 58 1(953); *Restatement (Second) of Contracts* § 351(1) 1(981) ("Damages are not recoverable for loss that the party in breach did not have reason to foresee as a probable result of the breach when the contract was made."). *See also California Fed. Bank, FSB v. United States*, 245 F.3d 1342, 1349 (Fed. Cir. 2001) ("Lost profits are a recognized measure of damages where their loss is the proximate result of the breach and the fact that there would have been a profit is definitely established, and there is some basis on which a reasonable estimate of the amount of the profit can be made.") (quoting *Neely v. United States*, 152 Ct. Cl. 137, 285 F.2d 438, 443 (1961) ("*Neely I*")).

Energy Capital Corp. v. United States, 302 F.3d 1314, 1324-25 (Fed. Cir. 2002).

A. Causation

Plaintiff must prove that defendant's breach caused it to lose profits, "inevitably and naturally, not possibly nor even probably." *Myerle v. United States*, 33 Ct. Cl. 1, 27 (1897).[18] We ruled in the first trial that CalFed "did not prove that shrinking the bank was a result of the breach, or even that it was harmful. It may have been the result of prudent management decisions." *California Fed. Bank v. United States*, 43 Fed. Cl. 445, 459 (1999).

Mr. St. Dennis testified that shrinking the bank for any reason was "generally a very bad idea." Mr. Brummett added, "if we were bigger, we would have made more money." These statements are not supported by the record of this trial. CalFed lost $20 million in 1990 with $20 billion in assets; it earned a profit during 1995-1996 with less than $15 billion in assets. Shrinking the bank in the midst of a serious recession in fact was a very good idea for CalFed.

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[18] The trial court in *Energy Capital*, a case affirmed and apparently well-regarded by the Federal Circuit, suggests that Myerle has been supplanted by a less strict test of whether defendant's breach was "a substantial factor" in causing the injury. *Energy Capital Corp. v. United States*, 47 Fed. Cl. 382 (2000). The Court of Federal Claims rejected the notion that damages from the breach must be "inevitable," and required only that the plaintiff "prove that the breach was a 'substantial factor' in causing its losses, the test in the majority of jurisdictions." *Energy Capital*, 47 Fed. Cl. at 395. We have not considered whether *Myerle* has been overruled, but plaintiff's counsel agreed that damages must flow "naturally and inevitably" from the breach. If the standard has changed, the result in this case nevertheless remains the same.

B. Foreseeability

The effect of independent business decisions on foreseeability is discussed in *Myerle v. United States*, 33 Ct. Cl. 1 (1897). "For damage to be direct there must appear no intervening incident . . . ." *Id.* at 27.

> But if they are such as would have been realized by the party from other independent and collateral undertakings, although entered into in consequence and on the faith of the principal contract, then they are too uncertain and remote to be taken into consideration as a part of the damages occasioned by the breach of the contract in suit.

Id. at 26.

When damages are foreseeable, a "jury verdict" approach to calculating them may be appropriate. *See, e.g.*, *Bluebonnet Sav. Bank, FSB v. United States*, 47 Fed. Cl. 156 (2000), *rev'd on other grounds*, 266 F.3d 1348 (Fed. Cir. 2001). That case contrasts with plaintiff's foreseeability argument here. The agreement breached in *Bluebonnet* was a regulatory forbearance directly addressing payment of dividends. The plaintiff claimed that it experienced increased costs of financing as a result of not having available to it the dividends that defendant promised. The trial court found that "it was foreseeable under the circumstances that [plaintiff] would incur the increased financing costs they now claim without dividends to assist in obtaining additional loans and repaying existing debt." *Bluebonnet Sav. Bank, FSB v. United States*, 47 Fed. Cl. 156, 172 (2000), *rev'd on other grounds*, 266 F.3d 1348 (Fed. Cir. 2001).

According to plaintiff, the Federal Circuit held implicitly in our case that lost profits were foreseeable at the time of contracting. We do not see such a holding in the Circuit's

opinion. The court ruled only that plaintiff submitted sufficient genuine issues of material fact to avoid summary judgment on lost profits. "Both the existence of lost profits and their quantum are factual matters that should not be decided on summary judgment if material facts are in dispute." *California Fed. Bank, FSB*, 245 F.3d at 1350 (citing RCFC 56(c)).

Defendant could not have foreseen at the time of contracting that plaintiff would make a management decision to sell CTL because of a "moral obligation" to do so. It could not have foreseen plaintiff's independent decision to sell nearly 25,000 adjustable rate mortgages after the breach.

> The damage must be such as was to have been foreseen by the parties, who are assumed to have considered the situation, the contract, and the usual course of events; but eliminated from this consideration must be any condition of affairs peculiar to the contractor individually in the particular case and not of general application under similar conditions. There must not be two steps between cause and damage.

Myerle v. United States, 33 Ct. Cl. 1, 27 (1897). Plaintiff's sale of CTL and its ARM's are the sorts of "independent and collateral undertakings" that the Court of Claims considered to be too remote and too uncertain to allow recovery for their consequences. *See Myerle*, 33 Ct. Cl. at 26 (citing *Fox and Another v. Harding and Another*, 61 Mass. 516, 7 Cush. 516 (1851)).

Defendant could not have foreseen the effects of the California real estate recession. For two years after FIRREA, plaintiff's business plans projected continued growth, not

shrinkage. The recession caused CalFed to shrink the bank. Management did not view the new law, including the phase-out of goodwill, as a bad thing.[19] The bank thought that FIRREA would be an opportunity to position the bank at a competitive advantage compared to other thrift institutions that were not so well-managed.

Plaintiff argues that foreseeability can be determined by the purpose of a contract, and that courts have recognized the importance of defendant's promise that goodwill could be counted as capital. The Supreme Court held that goodwill promises "allow[ed] the thrift to leverage more loans (and, it hoped, make more profits)." *United States v. Winstar Corp.*, 518 U.S. 839, 851 (1996). The non-breaching party is entitled to "benefits he expected to receive had the breach not occurred." *Restatement (Second) of Contracts* § 344(a). The benefits that plaintiff expected to receive were ("it hoped") higher profits from the ability to leverage goodwill as though it were capital. Plaintiff did not prove that losing goodwill or replacing it with tangible capital affected its profits adversely.

Management sold the divested assets for business reasons. CTL did not fit the bank's investment strategy and it sold for $30 million. Plaintiff sold nearly 25,000

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[19] Mr. St. Dennis attributed the bank's return to profitability in 1995 to "the results of its restructuring in prior years to meet the new capital requirements of FIRREA." He thought the enactment of FIRREA was a benefit not only to CalFed but also to the entire industry. Former CEO Mr. Callender testified that FIRREA caused the bank to sell high-risk loans and non-performing loans. The record contains many positive references to Congress' action and the importance of increasing tangible capital ratios. Goodwill is not tangible capital.

adjustable rate mortgage loans despite a severe real estate recession and recorded capital gains of $28 million to help offset its losses.

We agree with plaintiff's statement that, "CalFed has demonstrated . . . [that the Government] foresaw, or should have foreseen, that a breach of its goodwill promises could cause CalFed to shrink." *See, e.g., California Fed. Bank, FSB*, 245 F.3d at 1350 (government "knew that breaching this agreement would cause [CalFed] to adjust its capital ratio. That is, it knew that [CalFed] would have to reduce its assets or increase its capital."). Plaintiff adds, however, that such evidence also shows that the Government understood that reduction in asset size would reduce the thrift's earning capacity. This part of plaintiff's argument does not follow logically, and it is not supported by the record of this trial. Defendant "could not foresee what effect this adjustment would have on plaintiff's profits. The Government promised to permit the use of goodwill as capital, but it did not guarantee plaintiff that its use of the additional leverage would be profitable." *See California Fed. Bank v. United States*, No. 92-138C (Fed. Cl. November 12, 1998) (Order).

C. Reasonable Certainty

"If a reasonable probability of damage can be clearly established, uncertainty as to the amount will not preclude recovery." *California Fed. Bank, FSB v. United States*, 245 F.3d 1342, 1350 (Fed. Cir. 2001) (quoting *Locke v. United States*, 151 Ct. Cl. 262, 267, 283 F.2d 521, 524 (1960)). The fact that plaintiff would have made a profit must be "definitely established, and [there must be] basis on which a reasonable estimate of the amount of the profit can be made." *California Fed. Bank, FSB*, 245 F.3d at 1349 (quoting *Neely v. United States*, 152 Ct. Cl. 137, 147, 285 F.2d 438, 443 (1961)).

> The ascertainment of damages is not an exact science, and where responsibility for damage

> is clear, it is not essential that the amount thereof be ascertainable with absolute exactness or mathematical precision: It is enough if the evidence adduced is sufficient to enable a court or jury to make a fair and reasonable approximation.

Bluebonnet Sav. Bank, FSB v. United States, 266 F.3d 1348, 1355 (Fed. Cir. 2001) (internal quotations and citations omitted).

Plaintiff contends that Bluebonnet and similar cases support a judgment in its favor so long as the court can make a "reasoned inference" as to the amount of damages chargeable to defendant (quoting *Chalender v. United States*, 127 Ct. Cl. 557, 566, 119 F. Supp. 186, 192 (1954)). The Government as the breaching party should not benefit from any difficulty that the bank might have in proving damages, plaintiff argues. *See, e.g., Energy Capital*, 302 F.3d at 1327 ("[T]he risk of uncertainty must fall on the defendant whose wrongful conduct caused the damages.") (internal quotations omitted).

CalFed did not prove its lost profits case using these standards or any others that are discussed in the case law. Plaintiff did not establish damages from the category that it describes as "other foregone assets." We found no basis for determining lost profits with reasonable certainty, by reasoned inference, or by reasonable estimate. Such a finding would be purely speculative.

IV. OTHER ISSUES

CalFed's responses to defendant's criticism of Professor James' testimony and his lost profits model was that such criticism ignored the testimony of plaintiff's fact witnesses. Professor James made the same point often, and criticized defendant's experts on that basis. Professor James' model depends entirely on what he was told by management. His

reliance on management was absolute and at times naive. We did not find such an approach to be helpful in this case. Professor James did not express expert opinions on whether it was necessary for the bank to sell adjustable rate mortgages after the breach; whether CalFed would have raised capital in 1989 and 1990 irrespective of the breach; or whether it was necessary to sell CTL or the adjustable rate mortgages because of the breach. Professor James' trial testimony and that of several management witnesses occasionally was inconsistent with their deposition testimony.

Several fact witnesses were paid litigation consultants for CalFed, and have been for years. At least two witnesses have owned warrants for shares of any judgment that plaintiff could have been awarded in this case. One witness testified that the value of his warrants was "less than one percent of my net worth," an odd and meaningless response to a question about the extent of his financial stake in the outcome of this case.

CalFed issued offering circulars in 1995 and 1996 to potential investors in shares of a judgment in this case. The Securities and Exchange Commission requires disclosure of all material facts concerning the litigation in such circumstances. CalFed listed in the offering circular four causes of damage to the bank as a result of defendant's breach. Not one was argued in plaintiff's case during this trial. The damage theories that plaintiff presented to this court to support a judgment of over a half-billion dollars against the Government are not mentioned in the circular. In fact, plaintiff now states that the damages listed in the circular would have occurred irrespective of the breach.

Several CalFed witnesses attempted semantic twists of language from the circular to encompass the sale of ARMs.

Such efforts only harmed the credibility of their testimony.[20] Material disclosures should have been expressed clearly in the offering circular as required by the SEC, if they were valid.

Mr. Doug Wallis was CalFed's General Counsel and was responsible for drafting the offering circular. He testified that the sale of adjustable rate mortgages as an element of damages was not a consideration for him when the circular was drafted.[21] Even so, he attempted to force that meaning into the language of the circular during his testimony. He referred to the phrase "income-earning assets" as one that could include the sale of single-family adjustable rate mortgages. His explanation of how the offering circular could be interpreted to include adjustable rate mortgages was strained at best, and his testimony concerning CTL and the bank's "moral obligation" was not credible.[22] As an attorney

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[20] One witness testified that the sale of ARMs, which represents seventy percent of the damages claimed from the breach, was not mentioned in the offering circular because "it was obvious." Another suggested that the ARMs could be found in language such as "including without limitation," or "in part."

[21] Q Did it occur to you, sir, in 1995 that an investor could look at that term "income-earning assets" and not know what type of assets CalFed was referring to? A In 1995, I never even thought about that. I never thought about any of the things we're discussing today in 1995.
Q You weren't thinking about adjustable-rate mortgages, were you . . . in connection with the offering circular.
A That's correct.

[22] Q Did CalFed feel some sort of moral commitment to the regulators that was leading it to sell CTL in 1993?

[Footnote continued on next page]

for the bank, he had challenged regulators on the enforceability of other agreements, including capital maintenance agreements applicable to the holding company. He included in the bank's 1991 10-K filing, "the parent company believes that substantial legal questions exist as to whether there is an enforceable obligation, agreement or stipulation pursuant to which it can be required to make a capital contribution to the bank."

V. REPLACEMENT OF CAPITAL

The 1995 offering circular states:

> Further, as a result of its loss of regulatory capital after FIRREA, the Bank was required to restructure shareholder equity .... During the phase-out period (1989-94), the Bank raised $346 million of new common equity and $266 million of noncumulative preferred equity, in part, to replace the Supervisory

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[Footnote continued from previous page]

A Well, we had agreed to sell it in the capital plan. I guess that's a moral commitment. It was an agreement with the regulators.

Q [D]id CalFed feel a moral commitment to sell CTL, even if it wasn't required under the terms of the agreement?

....

A Because it was a part of the capital plan, we felt we had agreed to sell it, and we did, in fact, sell it.

QDid CalFed feel a moral commitment to sell CTL, even if it did not need CTL to meet its capital requirements and even if the plan was no longer in effect?

A Yes, because we had included it in the capital plan .... We had committed to the regulators in the capital plan to sell it, and we felt that we had to make good on that commitment.

Goodwill that was no longer includable in the Bank's regulatory capital.

We ruled after the first trial that CalFed was successful in replacing its goodwill, and in fact never fell out of capital compliance. "The costs of raising replacement capital are the damages that we award by this opinion . . . ." *California Fed. Bank v. United States*, 43 Fed. Cl. 445, 460 (1999). These damages were calculated by plaintiff's cost of raising over $400 million in capital to replace the $390 million of goodwill that plaintiff lost as a result of the breach. The cost of raising capital necessary to replace the lost goodwill was approximately $23 million.

This holding was affirmed by the Federal Circuit on appeal. "We see no clear error in the court's factual finding that the flotation costs provided an appropriate measure of CalFed's damages incurred in replacing the supervisory goodwill with tangible capital." *California Fed. Bank, FSB v. United States*, 245 F.3d 1342, 1350 (Fed. Cir. 2001), *cert. denied*, 534 U.S. 1113 (2002). Defendant argued that plaintiff could not show lost profits after the goodwill was replaced, and that any such testimony would be improper according to the law of the case doctrine. We did not rule on defendant's motion in limine at the time because of the Federal Circuit's remand order. The issue is now moot and defendant's motion therefore is DENIED.

VI. CONCLUSION

Plaintiff did not satisfy any of the legal requirements that would entitle the bank to lost profits. If the bank had proven even some damages, uncertain only as to amount, arguably we could have made a jury verdict award. It did not, however. Even if plaintiff had satisfied the legal requirements, it could not have recovered because the witnesses did not provide a credible factual basis for supporting damages.

Defendant breached plaintiff's contract. The results could have been serious, as they have been in other cases. But the Government did not take "real" assets from the bank. Congress required plaintiff to remove from its books an accounting entry and to replace it with tangible capital. All of the new capital went into the bank, and the bank benefitted.

Defendant often argues that the Government did plaintiff a favor by breaching its contract. It is not necessary to address this point, but in fact the bank replaced its supervisory goodwill and streamlined its books to meet new capital requirements. Through shrinkage, the bank reduced its exposure to severe losses during a serious recession. Many banks in similar circumstances did not survive.

The Clerk will dismiss plaintiff's complaint. No costs.

Supreme Court, U.S.
FILED
JUL 29 2005
OFFICE OF THE CLERK

(3)

No. 04-1557

In the Supreme Court of the United States

CALIFORNIA FEDERAL BANK, FSB, PETITIONER

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FEDERAL CIRCUIT

BRIEF FOR THE UNITED STATES IN OPPOSITION

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QUESTIONS PRESENTED

1. Whether petitioner properly preserved the issue of whether there is a conflict within the Federal Circuit concerning the calculation of damages in cases like this one.

2. Whether this Court's review is warranted to determine whether there is an internal conflict within the Federal Circuit between the decision in this case and that court's decision in a subsequent case.

3. Whether the Federal Circuit correctly affirmed the trial court's findings on replacement-cost damages in this case.

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No. 04-1557

CALIFORNIA FEDERAL BANK, FSB, PETITIONER

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FEDERAL CIRCUIT

BRIEF FOR THE UNITED STATES IN OPPOSITION

OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 1a-17a) regarding the award of capital replacement costs, liability, and other matters is reported at 245 F.3d 1342. The opinion of the court of appeals after remand proceedings on certain remedial issues (Pet. App. 122a-143a) is reported at 395 F.3d 1263. The initial opinion of the Court of Federal Claims regarding the award of petitioner's capital replacement costs and other remedial issues (Pet. App. 18a-56a) is reported at 43 Fed. Cl. 445. The opinion of the Court of Federal Claims regarding liability (Pet. App. 57a-121a) is reported at 39 Fed. Cl. 753. The opinion of the Court of Federal Claims on remand regarding remedies (Pet. App. 144a-173a) is reported at 54 Fed. Cl. 704.

JURISDICTION

The judgment of the court of appeals was entered on January 19, 2005. On April 7, 2005, the Chief Justice extended the time within which to file a petition for a writ of certiorari to and including May 19, 2005. The petition for a writ of certiorari was filed on May 19, 2005. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

This is one of approximately 39 remaining (out of an original total of approximately 120) *Winstar*-related cases (see *United States* v. *Winstar Corp.*, 518 U.S. 839 (1996)) that were filed after the enactment of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA), Pub. L. No. 101-73, 103 Stat. 183, and that are still pending in the Court of Federal Claims and the Federal Circuit. In this case, the court of appeals affirmed the trial court's ruling that the United States was liable for breach of contract with petitioner; the government has filed a conditional cross-petition challenging that ruling. See *United States* v. *California Federal Bank*, No. 04-1709. With respect to damages, the Court of Federal Claims awarded petitioner approximately $23 million in damages for costs incurred in mitigation of the breach. On petitioner's initial appeal in this case, the court of appeals affirmed that award, but remanded for further proceedings on other damages theories. This Court denied petitioner's first petition for certiorari. On remand, the trial court concluded that no further damages should be awarded. On petitioner's second appeal, the court of appeals affirmed.

Petitioner does not now seek this Court's review of any ruling of the court of appeals' on petitioner's second

appeal, nor does petitioner seek plenary review of any aspect of the court of appeals' ruling on petitioner's first appeal. Instead, petitioner contends that the court of appeals' decision on petitioner's first appeal conflicts with later decisions of that court, and that this Court should summarily grant the petition, vacate the decision of the court of appeals, and remand, based on petitioner's claim that there is an internal conflict within the Federal Circuit.

1. a. During the early 1980s, rising interest rates threatened the survival of the thrift industry by forcing thrifts to pay higher rates to depositors than they were earning from their existing portfolios of long-term, fixed-rate mortgages. *Winstar*, 518 U.S. at 845. Petitioner California Federal Bank (CalFed) was among the thrifts whose existence was jeopardized by the interest rate squeeze. Indeed, as the trial court found, "Cal Fed would not have survived had interest rates stayed at the high levels of the early 1980s." Pet. App. 30a.; see *id.* at 52a ("Credible expert testimony established that plaintiff would not have survived further increases in interest rates during those years."). By 1982, CalFed was economically insolvent by anywhere from $1.1 to $1.6 billion. *Id.* at 32a.[1]

Economically insolvent thrifts such as CalFed found it attractive to acquire other troubled thrift institutions. The acquiring thrift did not risk its own capital in the acquisition of additional customers and market share, because it had little or no capital left to lose. 2 C.A. App.

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[1] See 1 C.A. App. A1000231-A1000234, A1000250-A1000254, A1002226-A1002230, A1002202-A1002203, A1005015-A1005016, A1005031-A1005034, A1005041-A1005043; 2 C.A. App. A3000283-A3000289, A3000301-A3000305, A3000692, A3000708-A3000716, A3000789-A3000790, A3000791-A3000793, A3000794-A3000798.

A3000709-A3000712. Indeed, ultimate liability for both its own deposits and those of the acquired thrift remained with the federal insurance fund. *Glendale Fed. Bank* v. *United States*, 239 F.3d 1374, 1381-1382 (Fed. Cir. 2001) (recognizing that government remained contingently liable for net liabilities even after merger). Yet, if interest rates fell and restored the industry to profitability, the net liabilities of both the acquiring and acquired thrift would disappear, leaving the acquiring thrift with ownership of an additional valuable thrift franchise. 2 C.A. App. A3000722. The acquisition also could lead to a variety of accounting and regulatory benefits for the acquiror, including an increase in reported "accretion" income and the treatment of the acquired thrift's net liabilities as regulatory capital in the form of "goodwill." See, *e.g.*, *Winstar*, 518 U.S. at 851-853 (noting the favorable accounting and regulatory treatment of goodwill); 12 C.F.R. 556.5 (a)(3) (1985); 2 C.A. App. A3000704.

b. CalFed made three acquisitions during the early 1980s that are relevant to its petition. In each instance, the acquired thrift institutions had significant net tangible liabilities on a market value basis, which were recorded on CalFed's balance sheet as goodwill and treated as regulatory capital pursuant to then-existing regulations. See generally *Winstar*, 518 U.S. at 848-851 (discussing regulatory treatment of goodwill).

First, in February 1982, CalFed acquired several thrift institutions in Georgia and Florida, known collectively as "Southeast." Pet. App. 20a & n.1. The Federal Savings and Loan Insurance Corporation (FSLIC) provided $9 million in cash assistance for the transaction, and CalFed recorded on its balance sheet the acquired thrifts' assets and liabilities, and approximately $306

million in goodwill to be amortized over a period of 35 to 40 years. *Id.* at 3a, 20a.

Second, in October 1982, CalFed acquired the parent company of Brentwood Savings and Loan Association. In connection with the transaction, CalFed recorded Brentwood's assets and liabilities on its balance sheet, as well as approximately $315 million in goodwill to be amortized over a 35-year period. Pet. App. 4a; see 3 C.A. App. A5002325.

Finally, in January 1983, CalFed acquired Family Savings and Loan Association. CalFed recorded Family's assets and liabilities on its balance sheet, as well as approximately $18 million in goodwill to be amortized over a 40-year period. Pet. App. 5a.

2. Congress enacted FIRREA in 1989. Among other things, FIRREA required the phase-out of goodwill from regulatory capital over a five-year period. See *Winstar*, 518 U.S. at 856-857. This phase-out required CalFed to operate with the same ratio of tangible capital to assets as all other thrifts. 1 C.A. App. A1002170-A1002172, A1002178-A1002180. To the extent that CalFed had relied upon goodwill to meet its capital requirements, the phase-out required it either to shrink or to infuse more money into the thrift to replace the phased-out goodwill, thereby operating with more tangible capital and less debt. *Id.* at A1002170-A1002172. Between 1992 and 1994, CalFed raised more than $400 million in capital in a series of stock transactions, an amount greater than the $390 million in remaining, unamortized goodwill associated with the Southeast, Brentwood, and Family transactions. See Pet. App. 49a & n.13. Unlike goodwill, which is a non-earning asset, CalFed could invest the additional capital to earn a return, just as firms do when they voluntarily raise capital

to fund new investments. 1 C.A. App. A1002179, A1002169-A1002170; 2 C.A. App. A3000407-A3000408.

3. In 1992, CalFed filed a complaint in the Court of Federal Claims, alleging that the government had entered into contracts with CalFed when regulators approved each of the three acquisitions at issue, and that Congress had breached those contracts through the enactment of FIRREA. Pet. App. 3a-5a. In response, the government acknowledged that the Southeast acquisition involved a regulatory agreement, but denied that the regulatory approval of the Brentwood and Family acquisitions had resulted in contracts. In 1997, the Court of Federal Claims granted CalFed's motion for summary judgment on liability, concluding that the regulatory approval of all three acquisitions resulted in contracts and that the government was liable for damages for the breach of those contracts that resulted from FIRREA. *Id.* at 57a-121a.

4. CalFed pursued several theories of recovery. First, CalFed asserted a claim for over $600 million in lost profits, based on business opportunities with third parties that allegedly were forgone due to the phase-out of goodwill. Pet. App. 10a-14a. Second, CalFed sought $409 million in restitution, a figure corresponding to the amount of net liabilities assumed by CalFed in connection with the acquisitions of Southeast and Brentwood ($620 million) minus CalFed's calculation of its earnings from the acquired thrifts. *Id.* at 15a. Third, CalFed presented a hypothetical "cost of replacement" claim, based upon a model purporting to show that it would cost almost $1 billion in cash to replace the $390 million in goodwill that was excluded from CalFed's regulatory capital as a result of FIRREA.